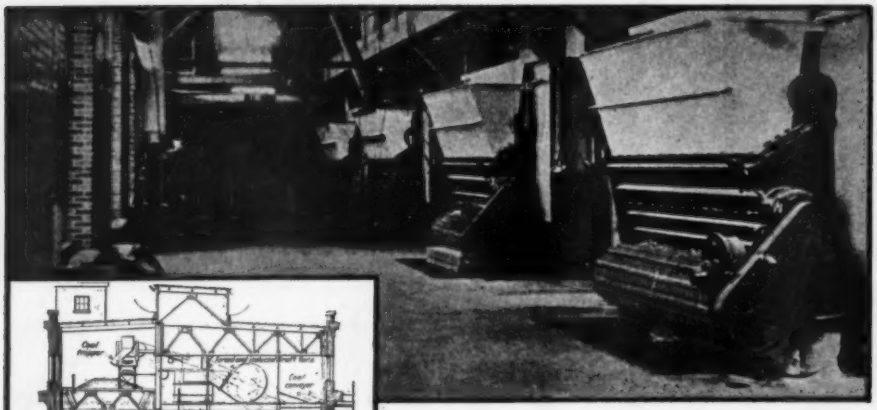
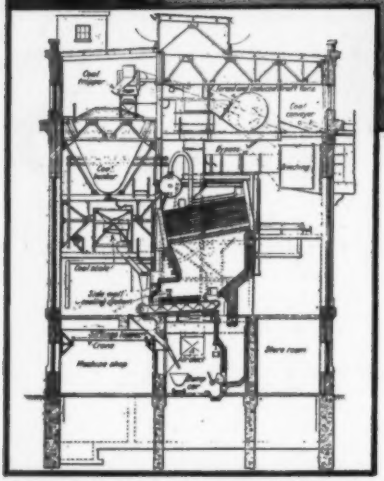
Public Utilities

FORTNIGHTLY

February 6, 1930

PUBLIC UTILITIES REPORTS, INC.
WASHINGTON, D. C.





Cross section through the Howard Bend Pumping Station showing the arrangement of C-E Boiler (Heine cross drum Type) and C-E Stoker (Green Forced Draft Type). All four units are similarly arranged.

DISTINCTIVE INSTALLATIONS OF

C-E Equipment

The Howard Bend Pumping Station, St. Louis, is one of the latest and most modern pumping stations in America and is representative of the changing trend toward improved steam plant operation.

The boiler room was specially designed to assure reliability and flexibility. C-E Boilers (Heine cross drum Type) and C-E Stokers (Green Forced Draft Type) were chosen.

The steam pressure is higher than that normally used in water works, the boilers being operated at 325 lb. pressure and superheat of 245 deg. fahr. giving a final steam temperature of approximately 670 deg. Another departure from ordinary water works practice is drawing CO_2 from the boiler flue gas to charge the water in the process of purification.

• • •

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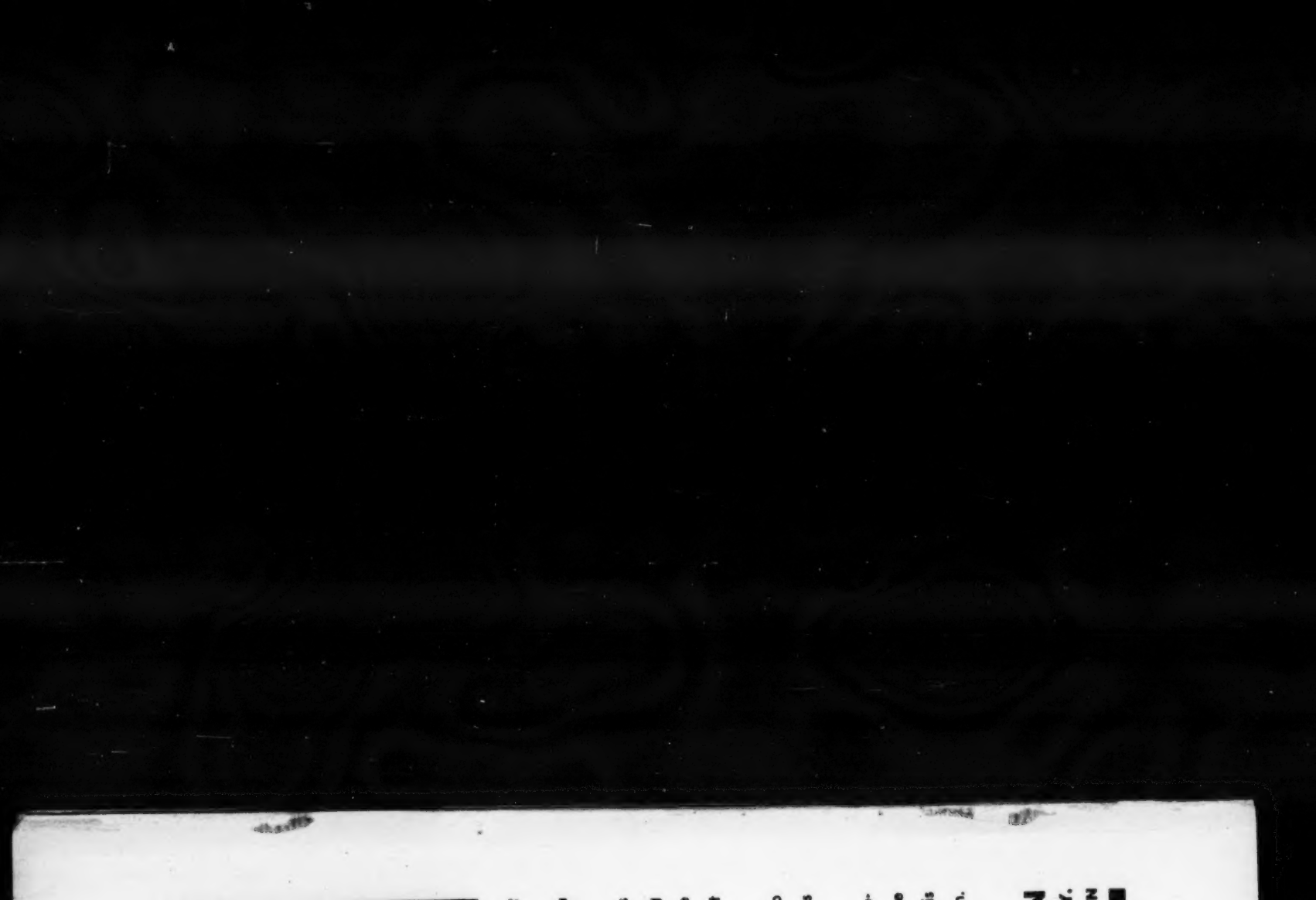

Public Utilities

FORTNIGHTLY

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Including the Issues of July 11, 1929
to December 26, 1929

PUBLIC UTILITIES REPORTS, INC.
WASHINGTON, D. C.

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HENRY C. SPURR, *Editor*
KENDALL BANNING, *Editorial Director*
ELLSWORTH NICHOLS, *Associate Editor*
FRANCIS X. WELCH, *Contributing Editor*
M. M. STOUT, *Assistant Editor*

Public Utilities Fortnightly

VOLUME V — *February 6, 1930* — NUMBER 3

Contents of previous issues of PUBLIC UTILITIES FORTNIGHTLY *can be found by consulting the "Industrial Arts Index" in your library.*

PUBLIC UTILITIES REPORTS, INC., PUBLISHERS

PUBLIC UTILITIES FORTNIGHTLY a magazine dealing with the problems of utility regulation and allied topics, including the official decisions of the State Commissions and courts; endorsed by the National Association of the Utility Industry and by the National Association of Railroad and Utilities Commissioners, and supported in part by those conducting public utility service, manufacturers, bankers, accountants and other users of the publication. Published every other Thursday; 75 cents a copy; $15.00 a year; with bound volumes and Annual Digest, $32.50 a year. Editorial and advertising office, Munsey Building, Washington, D. C., circulation office, Duffy-Powers Building, Rochester, N. Y. Entered as second-class matter April 29, 1915, at the Post Office at Rochester, N. Y., under the Act of March 3, 1879.

Pages with the Editors

TWICE during the past fortnight has PUBLIC UTILITIES FORTNIGHTLY stepped into national spot-light that beats down upon the country's capital.

* *

AND on both occasions was this publication cited as an authority upon the subject of regulation of public utilities—in one instance by the United States Supreme Court and in the other instance by the United States Senate.

* *

WHEN the United States Supreme Court issues its interpretations of controverted legal issues, it practically makes law for the nation.

* *

RECENTLY that court made very important utility law indeed when it handed down its decision in the significant Baltimore Street Railway fare case—a decision that some regard as even more important than the famous O'Fallon case.

* *

THE editors are gratified to note that the legal decisions published in the "Public Utilities Reports" section of this magazine (which are issued annually in five bound volumes) rendered yeoman's service to our highest court in its deliberations; they were cited no less than forty-five times.

* *

IN the other instance the legislative branch of our government took official cognizance of the part which PUBLIC UTILITIES FORTNIGHTLY is playing in the solution of the regulatory problems of the nation when SENATOR HUGO L. BLACK's article "No Broadcasting by Utilities," (which appeared in our issue of June 13, 1929) was reprinted in its entirety in the *Congressional Record*—on the motion of SENATOR SMITH W. BROOKHART.

* *

AND SENATOR SAM G. BRATTON's article "Let the Interstate Commerce Commission Regulate Aeronautics" (in the December 26 number) was reprinted in the *Congressional Record* on the motion of SENATOR MCKELLAR.

* *

IT is now in order for some Senator to move that the other side of these controversies be similarly spread upon the permanent records of the nation by having COL. HENRY A. BELLOWS' answer, "The Right to Use Radio," (which appeared in our issue of June 27, 1929), and SENATOR HIRAM BINGHAM's article "who Should Regulate the New Air Transport Utilities" (in the December 12 issue) reprinted also.

* *

WITH all of these interesting and illuminating documents before them—representing divergent points of view, and each written by a distinguished publicist—the gentlemen who constitute "the greatest deliberative body in the world" should be in a better position to pass upon legislative problems that will best serve the public interests.

* *

ANOTHER exceedingly important problem in regulation that is giving rise to honest differences of opinion is the holding company.

* *

THIS subject is tackled with characteristic vigor by HON. JOHN F. SHAUGHNESSY, Chairman of the Nevada Public Service Commission, in the leading article of this issue of the magazine—starting on page 131.

* *

CHAIRMAN SHAUGHNESSY has served twenty-three years as a member of the Nevada Railroad Commission and of the present Public Service Commission which later took its place; he has been Chairman since 1919.

JOHN F. SHAUGHNESSY
Chairman, Nevada Public Service Commission

(Continued on page VIII)

IVY L. LEE

PROF. GERALD M. FRANCIS

HE was born in Oshkosh, Wisconsin; attended the public schools, became a "printer's devil," then a railroad brakeman, a conductor and supervisor of construction, first on the Santa Fe and later on the Colorado and Southern roads; he came to Nevada in 1904 as assistant superintendent in charge of transportation with the Southern Pacific.

* *

AND since 1907 his life has been devoted to public service.

* *

IVY L. LEE, whose article "the Man Behind Steps Out" appears on pages 141 to 145 of this number, is one of the oldest, the most experienced and the most successful of public relations counsels—a form of service which he has raised to the dignity of a profession.

* *

ONLY a few weeks ago our esteemed contemporary *The New Republic* published a four-page personality sketch of MR. LEE, written by SILAS BENT—which is in itself a tribute to the position which MR. LEE occupies in his special field.

* *

FROM this article—which appeared in a periodical that views with alarm rather than points with pride, and which is consistently critical of nearly all the activities of business corporations—we quote the following terse but illuminating paragraph:

* *

> "Ivy Ledbetter Lee—for this was the mellifluous name given the Georgia prodigy more than half a century ago—is a member of expensive and more or less exclusive clubs abroad and at home, dwells in the fashionable East Sixties, has lectured to the London School of Economics, pontificates on our recognition of Soviet Russia, and is confidential adviser to the elder and junior Rockefellers, Charles M. Schwab, W. W. Atterbury, the Armours and other millionaires. No wonder he has been 'the king of press agents.' This, however, is not what he calls himself. He is an 'adviser' and 'counsel' in public relations."

* *

IT might be added that MR. LEE is a graduate of Princeton, and is widely known as the editor of the *Subway Sun* and the *Elevated Express*—both of which are familiar to those who ride in New York's underground and overhead railways.

* *

THE steady growth of public utility companies, and the gradual and inevitable consolidations and interconnections that are taking place, are giving rise to economic and regulatory problems that sooner or later must be solved.

* *

WHAT some of these problems are, and what their solutions may conceivably be, are outlined on pages 152 to 166 of this number by GERALD M. FRANCIS, Professor of Economics at Rockford College, Illinois.

* *

PROF. FRANCIS graduated from Knox College in 1921; was a Fellow in Public Utility Economics at the University of Illinois from 1924 to 1927; received his M. A. degree in economics from that institution in 1925, and his Ph. D. degree in 1927.

* *

DURING the summers of 1925 and 1926 he was engaged in research work with public utility companies in the Chicago area, in partial preparation of a study of operating and financial tendencies of interconnection of electric utility systems.

* *

The next issue will be out February 20.

—THE EDITORS.

FEBRUARY

Reminders of Coming Events

ALMANACK

Notable Events and Anniversaries

6	T*h*	JOHN STEVENS, "father of the American railroad," got a charter from the New Jersey legislature for the first railroad for operation by steam locomotives, 1815.
7	F	The first telephone call between New York and Chicago was put in, 1892. ¶*The National Electric Light Association convention will open in San Francisco June 16.*
8	S*a*	Boston newspapers institute a campaign against the reckless driving of street cars, which led to destructive collisions—besides being cruel to the horses, 1890.
9	S	Bath, Maine, launched the first steel sailing ship, 1894. The Australian Commonwealth radio station transmitted its first commercial radiogram, 1912.
10	M	The General Assembly of Illinois granted a charter to the Illinois Central Railroad, 1851. Philadelphia streets were lighted by gas for the first time, 1835.
11	T*u*	The U. S. Shipping Board voted to sell eleven ships, including the *"Leviathan"* for $16,300,000 by which the government would retire from marine business, 1929.
12	W	The Illinois legislature granted charters to three railroads, all of which were later incorporated in the Chicago, Burlington & Quincy Railroad, 1849. *Lincoln's Birthday.*
13	T*h*	A locomotive valve gear, increasing haulage power of locomotives was invented by J. T. MARSHALL, 1902.
14	F	The Arizona Corporation Commission, created as a state department by the Constitution of the State of Arizona, took effect, 1912. ¶*St. Valentine's Day.*
15	S*a*	The first spike was driven in the construction of the Northern Pacific Railroad lines with impressive ceremonies, 1870.
16	S	The Panama Canal Commission unanimously recommended that a sea-level canal be built in twelve years at a cost not to exceed $230,000,000, 1905.
17	M	The first practical electrical street-car line in Ohio was operated in Cleveland, over a 2-mile track, 1884. The first telephone exchange in California opened, 1878.
18	T*u*	The Railroad Commission of Oregon was created by an act of the legislature, 1907; it was supplanted by the Public Service Commission of Oregon in 1915.
19	W	The public stood aghast as the London-Glasgow express train smashed all existing speed records by traveling the 472½ miles between those cities in 10¼ hours, 1848.

"In the long run, on the general average, our ultimate success or our ultimate failure is but the measure of our deserts."

—PRESTON S. ARKWRIGHT

From a painting by Fred Dana March

Watch Towers of American Industry

Public Utilities
FORTNIGHTLY

VOL. V; NO. 3 FEBRUARY 6, 1930

The Case of the Holding Company

A PRESSING PROBLEM IN REGULATION

Will the power of the State Commissions be strengthened—or the process of centralizing control of public utilities in Washington be extended?

BY J. F. SHAUGHNESSY
CHAIRMAN, PUBLIC SERVICE COMMISSION OF NEVADA

REGULATION is the policy which has been adopted by the people of our country for the purpose of dealing out even-handed justice as between its utilities and railroads and the recipients or patrons of services rendered by these public agencies.

This policy has been adopted in lieu of anything approaching a statewide, or a nation-wide, plan of governmental operation.

With minor exceptions, and for all practical purposes, the states remain in full regulatory control of the public utilities under the jurisdiction of their various Commissions, although it is recognized there is a possibility, based on later day decisions of our United States Supreme Court, of the Federal Government invading this field of activity—and this despite the fact that the railroad services, electrical services, gas services, truck and bus services, and other utility services, are essentially local in their characteristics.

WHETHER justified or not, an adverse public sentiment has been aroused against holding companies, which is exerting an unfavorable influence against the private operation of public utilities under state regula-

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WHETHER justified or not, an adverse public sentiment has been aroused against holding companies, which is exerting an unfavorable influence against the private operation of public utilities under state regula-

tion, and the trend is toward Federal control.

The Federal Trade Commission has been engaged in the collection and preparation of all information available on intercorporate relationships and the Interstate Commerce Committee of the Senate has been conducting hearings on proposed legislation to create a new Federal agency with jurisdiction over communication and power companies engaged in interstate commerce.

It is obvious that one of the primary purposes of these inquiries is to secure information which will enable Congress to determine what ought to be done to bring holding companies under public control if the problems which they present are found to be such as to warrant legislation. These investigations are the outgrowth of a widespread opinion that because of intercorporate relationships and interstate activities the operating companies are evading complete regulation under the system of state supervision.

It is contended that in some cases companies purchase public utility properties at prices in excess of real value and turn them over to holding companies at a profit, and that these holding companies thereafter turn them over to operating companies for operation—resulting in detriment to either the using or investing public. It is contended that the investor desires and is entitled to sound securities, while the consumer is entitled to just and reasonable rates; that there is no room for pyramiding values and operating costs in the public service; that these holding companies exact unreasonable service charges from the subsidiary operating companies to cover executive, security, material, and construction services; that these are matters of such importance that they should be subject to regulation as to their fairness, and that there has been a refusal on the part of some holding companies to disclose the details of those charges before Commissions and courts.

To the extent that these allegations are true it must be admitted that they will not stand the test of fair analysis and, if persisted in, must of necessity fall under the ban of just public condemnation. It is, of course, one of the major functions of the State Commissions to prevent such practices.

There are, without doubt, benefits to be derived by the public from the operation of large holding companies that control a number of utility companies. The principle advantage lies in the ability of the small utility to finance its new construction and additions and betterments at lower cost for quantity purchase of materials and at moderate rates of interest through the medium of the holding company. The holding company, with its many companies and activities, is able to maintain a staff of experts in every line of public utility endeavor —such as auditors, engineers, and finance experts. These experts would not be available to any one small company except at prohibitive cost. Through larger purchases of materials and supplies, the holding company should be able to secure better prices for the subsidiary. The holding company is also able to maintain an organization for the construction of

utility properties, which should effect economies in the cost of new construction for subsidiaries.

THERE are two outstanding difficulties in the attempt by states to regulate the relations between holding companies and their operating subdivisions:

(1) The fact that holding companies are very often not public utilities; and

(2) The interstate character of many of these organizations.

THE lack of control of local State Commissions over interrelated companies has been indicated in various state telephone rate cases where the company involved is a subsidiary of the American Telephone & Telegraph Company. Because they are beyond the power of the State Commissions, the fairness of the charges made by the holding company cannot be accurately determined, and as a rule the holding company is loath to supply the required information for rate investigations.

An important decision on the question of contracts between these related companies was rendered in the year 1923 by the Supreme Court of the United States, wherein the principle was announced that a State Commission may not adopt the functions of the public utility management, and that a contract between a parent company and an operating company will not be disturbed unless a clear showing is made of fraud practiced by the parent company, or a clear showing of undue influence exerted on the officers of the subsidiary company to induce or influence them to enter into the contract in question.[1] More recent decisions of the Supreme Court aid in explaining this proposition.

THE two outstanding public utility cases of the year 1929 were decided by the United States Supreme Court—Mr. Justice Stone speaking for the Court in able and well reasoned opinions.[2] One case originated in Kentucky and the other in West Virginia.

The Kentucky decision is of more than ordinary importance, for the reason that it strikes directly at the vice of the holding company with its intercorporate relations and contracts which have been set up for the purpose of concealing excessive earnings and preventing benefits that flow from the improvement in the art and from an increased volume of business reaching the public.

The United Fuel Gas Company, through its controlled company, the Warfield, did a natural gas business in Kentucky, West Virginia, and Pennsylvania. As it comes from the ground natural gas contains gasoline. In former years the United Company extracted this gasoline and sold it. In a previous rate case before the West Virginia Commission involving the same properties that body had held that 50 per cent of the net return from the sale of the gasoline should be credited to the gas business

[1] Missouri ex rel. Southwestern Bell Teleph. Co. *v.* Public Service Commission (1923) 262 U. S. 276, 67 L. ed. 981, P.U.R. 1923C, 193, 43 Sup. Ct. Rep. 544, 31 A.L.R. 807.

[2] United Fuel Gas Co. *v.* Railroad Commission (1929) 278 U. S. 300, 73 L. ed. 390, P.U.R.1929A, 433, 447, 49 Sup. Ct. Rep. 150; United Fuel Gas Co. *v.* Public Service Commission (1929) 278 U. S. 322, 73 L. ed. 402, 49 Sup. Ct. Rep. 157.

of the United Fuel Gas Company.

To escape from the effect of this requirement, a subsidiary, the Virginia Gasoline & Oil Company, was organized in West Virginia and a contract was entered into by which the United was to receive one-eighth of the gross profits from the gasoline extracted. The holding company issue arose out of the prescription of rates for natural gas by the Kentucky Commission, which the United Company attempted to have enjoined. Denial of an injunction in the lower court was affirmed. On the subject of the contract with the Virginia Gasoline & Oil Company, the Supreme Court, speaking through Mr. Justice Stone, said:

> "The West Virginia Public Service Commission having held that 50 per cent of the net return from the sale of gasoline should be credited to the gas business, the United Company organized a corporation, the Virginia Gasoline & Oil Company, and conveyed to it its gasoline extraction plant, receiving the stock of the new corporation in exchange.
>
> "Later it turned over this stock to its own stockholders of which there are but two, both corporations, in the same proportions in which they held stock in the United Company. It entered into a contract with this subsidiary by which it receives one-eighth of the gross profit from the gasoline extracted. . . .
>
> *"We need not labor the point that a public service corporation may not make a rate confiscatory by reducing its net earnings through the device of a contract unduly favoring a subsidiary or a corporation owned by its own stockholders.* Cf. Chicago & G. T. R. Co. v. Wellman (1892) 143 U. S. 339, 345, 36 L. ed. 170, 179, 12 Sup. Ct. Rep. 400. We recognize that a Public Service Commission, under the guise of establishing a fair rate, may not usurp the functions of the company's directors and in every case substitute its judgment for theirs as to the propriety of contracts entered into by the utility; and common ownership is not of itself sufficient ground for disregarding such intercorporate agreements when it appears that, although an affiliated corporation may be receiving the larger share of the profits, the regulated company is still receiving substantial benefits from the contract and probably could not have secured better terms elsewhere. Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Service Commission (1923) 262 U. S. 276, 288, 67 L. ed. 981, 986, P.U.R.1923C, 193, 43 Sup. Ct. Rep. 544, 31 A.L.R. 807; Houston v. Southwestern Bell Teleph. Co. (1922) 259 U. S. 318, 66 L. ed. 961, P.U.R. 1922D, 793, 42 Sup. Ct. Rep. 486.
>
> "But this case is not of that class." (The italics are ours.)

THE Kentucky Commission's order fixed a price of 32 cents per thousand cubic feet. It was shown that the Warfield paid to the United 30 cents at the state line, leaving a margin of but 2 cents for the cost of distribution and profit. In holding this contract of no significance in determining a reasonable rate to be charged by the distributing company, the court said:

> "Gas is sold by the United Company to the Warfield Company at the state line at 30 cents per thousand cubic feet, *but in view of the history and intercorporate relations of the appellants it is not contended that this contract rate is of any controlling significance in determining the propriety of the rate fixed by the Commission.* For this purpose appellants do not deny that they, with respect to their entire property and business, may be treated as a unit, and we so treat them." (The italics are ours.)

The Two Chief Problems in the Proposed Regulation of Holding Companies:

"THERE are two outstanding difficulties in the attempt by states to regulate the relations between holding companies and their operating subdivisions:

"(1) The fact that holding companies are very often not public utilities;

"(2) The interstate character of many of these organizations."

THE case is of unusual interest because it is thus made clear that a public utility cannot defeat the right of a state to fix reasonable rates through the device of reducing apparent earnings by giving unduly favorable contracts to related companies. The right of a state to examine the base of such contracts is affirmed.

While this case did not involve a contract for technical services by a holding company, but one where earnings were attempted to be concealed by the subterfuge of another corporation whose stock was held by the stockholders of the parent company, by analogy, however, the ruling made establishes the right of regulating authorities also to examine such contracts and to disallow the disbursements called for by them if they are found to be unreasonable or excessive.

The holding on the subject of the contract points the way in settling a matter which has been a source of vexation to regulating authorities for a long time. It will have a pronounced effect upon the discharge by those authorities of their duties in those cases that involve contracts between closely related corporations which hereafter come before them for consideration. The decision also throws light on the court's opinion in the Southwestern Bell Telephone Case, *supra.*

THE United Fuel decision, *supra,* is of major importance because a holding company for the future may not, because of its intercorporate relations, so execute contracts with its subsidiary companies as to enable it to withhold actual costs incurred, or of increasing the rate level to a point resulting in a higher return than would otherwise be the case, or of confusing a trial court when the question of confiscation is in issue. The reasonableness of the operating expenses is a fundamental element, equally as important as valuation in a rate case, and such investigations are to be clearly distinguished from managerial prerogatives. For this reason the decision means that something better must be pleaded than a mere statement that the contract is presumed to have been entered into in good faith and that to overcome this presumption it was incumbent upon the state authorities attacking it to

make a showing to the contrary.[3]

It also means that in so far as such intercorporate contract affects a member company, the cost actually assignable thereto shall be produced before the regulating tribunal, instead of the holding company refusing to do so on one pretext or another, as in the past.[4] The question of jurisdiction intervened in the Whitman Case, but it is fair to assume that the American Telephone & Telegraph Company will not again raise such an issue.

IN another case[5] Federal District Judge (now Circuit Judge) Dietrich severely criticized the plan of a subsidiary company, under review before him, making regular payments to its holding company to cover construction costs, and then making a present day price reproduction valuation and alleging that rates were confiscatory, without allowance for the economies and benefits that flowed from the holding company's management and construction services which had gone into operating expenses and reduced the amount of the net income. This was a three-judge case, and the court refused to grant an injunction, and very properly so, it seems.

The foundation for similar action noted in the Idaho Power Case, *supra,* has been laid by the supreme court of Michigan in ordering the ousting of the Michigan Bell Telephone under the statutes of that state.[6] The court held that because of stock ownership and control of the Michigan Company by the American Telephone & Telegraph Company, the latter was not, under the statutes of Michigan, entitled to make a valid contract with the operating unit in question, or, in other words, make a contract with itself, and, therefore, the Michigan Company should not have the right and privilege of credit in a computation of rates for payments made by it to the American Telephone & Telegraph Company under the license contract purporting to exist between the parent and member companies in question. But, on June 20, 1929, the court amended this order to provide that "nothing herein contained shall be construed to affect the right of the Michigan Bell Telephone Company upon its making proof thereof, in accordance with the requirements of due procedure, to have included in such computation of rates the reasonable value of the services rendered and the facilities furnished by the American Telephone & Telegraph Company."

THE significance of the court's finding is, of course, manifest. The American Telephone & Telegraph Company will in Michigan, and throughout the other states, under its forward-looking president, desire to co-operate fully under the terms of the amended order of the Michigan supreme court, to the end that only actual management and construction costs may be charged against its many patrons, and within which the regulating tribunals will be able to appraise the benefits and economies that flow from participation in wholesale construction, material, and

[3] Northwestern Bell Teleph. Co. *v.* Spillman (1925) 6 F. (2d) 663, P.U.R.1926A, 330.
[4] Chesapeake & P. Teleph. Co. *v.* Whitman (1925) 3 F. (2d) 938, P.U.R.1925D, 407.
[5] Idaho Power Co. *v.* Thompson (1927) 19 F. (2d) 547, P.U.R.1927D, 388.
[6] People ex rel. Attorney General *v.* Michigan Bell Teleph. Co. P.U.R.1929E, 27, 224 N. W. 438, decided March 29, 1929, amended June 20, 1929.

management costs of the company.

THE lack of power of State Commissions over interstate companies may be overcome by Congress lodging in the State Commissions power to regulate companies which, although operating interstate, are engaged primarily in the local distribution of the public utility service.

State Commissions may be empowered to exercise Federal powers, and, by the adoption of uniform rules of procedure, better results can be secured by the state officers who are in close touch with the people, who understand local conditions and who are known to the people, and in whom the people have confidence, being their selected representatives. In this connection the power of Congress to provide for this dual co-operative plan of machinery, or the exercise of concurrent jurisdiction, and to designate state officers as agencies, was validated by the United States Supreme Court when we were preparing for war in the Selective Draft Cases,[7] wherein the court held that the act of Congress was not void as a delegation of Federal power.

THE principle of utilizing State Commissions in co-operation with Federal agencies for the purpose of regulation has found its way into the regulation of railroads and is now proposed in pending legislation respecting interstate regulation of motor vehicle transportation, telephone, power, radio, and airplanes. The plan is cumbersome at best and entirely too slow and expensive, especially in so far as giving prompt and efficient relief to the people is concerned. If this policy is to be continued, State Commission laws should be amended to give jurisdiction to all State Commissions to act as regulating agencies, in fact, under Federal authority, for the prompt disposition of cases that are altogether local in character.

Much has been said before congressional committees and on the floors of the Senate and House about the beauty and efficiency of regional and district co-operation between Federal and state regulating tribunals, but definite action has not as yet been taken to see that it was or is adequately nourished. This is the outstanding defect in the co-operative plan. The people should not be led to believe that because Congress has provided for co-operative regulation between Federal and State Commissions that it will function efficiently unless a sufficient appropriation is in each case made by which the expenses of State Commissioners shall be defrayed when participating in such co-operative capacity. Otherwise failure looms ahead. Congress must provide adequate appropriations to take care of such dual exercise of regulation, if this policy is to be continued.

For these reasons a division of the work of regulating between Federal and state tribunals is imperative in order to prevent overburdening the Interstate Commerce Commission on the one hand, and on the other completely destroying the exercise of regulation over local railroads and utilities within the various states and which should be kept close to the people; otherwise the hardship of pro-

[7] 245 U. S. 366, 62 L. ed. 349, 38 Sup. Ct. Rep. 159.

Joint Regulation by State and Federal Bodies Is Impractical

"THE principle of utilizing State Commissions in co-operation with Federal agencies for the purpose of regulation has found its way into the regulation of railroads and is now proposed in pending legislation respecting interstate regulation of motor vehicle transportation, telephone, power, radio, and airplanes. The plan is cumbersome at best and entirely too slow and expensive."

ceeding before co-operative state tribunals and thence on appeal to the Interstate Commerce Commission will so complicate the hearings and disposition of cases and the expense thereof to litigants as to make regulation practically prohibitive to the small operators.

As to small telephone, power, stage line, or short line railroads, operating in part interstate, but rendering essentially local service, it will work a real hardship upon the public that receives these services or that is waiting for these services, if it is required to go into hearings, rehearings, and arguments, which may well require two or three years for disposal, and which we know from experience has not been unusual in other cases. The cost of such procedure becomes prohibitive to the small operator and is, therefore, not in the public interest unless it is desired to give a complete monopoly to the large operating or holding companies. It will take from the people of the various states that initiative which they are able to exercise today. The percentage of interstate stage, power, and independent telephone business of today is entirely too meagre to justify an appeal to some Federal tribunal at Washington. These agencies are in the formulative stage and should be allowed so to remain under such regulation as the respective states may exercise over them. In this manner there will be opportunity accorded for individual initiative and improvement in the art of furnishing transportation and utility services and of having it done by people who are respected citizens of the various commonwealths, and without the intervention of representatives from large financial centers far removed from the people who are being served.

AFTER the passage of the Transportation Act a co-operative agreement, pursuant to § 13 of the Interstate Commerce Act, was executed and has been in the process of growth since that time. It provides for the joint hearing of rate and service cases, or it may be assumed any other kind of a case by State and Federal Commissioners sitting jointly, involving two or more states, a group, a district, or the United States as a whole.

This plan has been working with more or less success. The states have demonstrated unqualifiedly their dis-

position to do their full share, but the practical effect of it has been to nullify almost everything in the way of an intrastate regulation of rates and other necessary police regulations. It has been of inestimable advantage to the railroads because of the avoidance of a multiplicity of hearings and suits, but while unifying the regulations imposed it has disclosed a serious defect in the machinery by the slowness with which it operates.

MANIFESTLY, the State Commissions have justified their good faith and their desire to give to the carriers a fair deal, and they have long since justified the conclusion enunciated by Chief Justice Taft, in construing the co-operative principle of the Transportation Act in the Wisconsin Passenger Fare Case,[8] wherein he said:

> " . . . in practice when the State Commissions shall recognize their obligation to maintain a proportionate and equitable share of the income of the carriers from intrastate rates, conference between the Interstate Commerce Commission and the State Commissions may dispense with the necessity for any rigid Federal order as to the intrastate rates, and leave to the State Commissions power to deal with them and increase them or reduce them in their discretion."

MANY Commissioners view with apprehension the present state of affairs and are exasperated with the frequent disregard by the Interstate Commerce Commission of its relation with State Commissions, and then quickly recognize the tremendous scope and multiplicity of the questions calling for attention and which must be handled by the Federal Commission. There is apprehension, and not without reason, that the present system of regulation will break down entirely, or reach almost the equivalent thereof, by such long-drawn out proceedings as thoroughly to discourage the public at large and force it to seek other remedies.

Yet, in the face of these conditions, we find a demand for the loading of additional duties upon the Interstate Commerce Commission.

IT is to be hoped that in any Federal legislation which may be enacted as a result of the present investigations, Congress will utilize the state regulating Commissions to the fullest practicable extent as the machinery with which to make regulation complete.

The State Commissions can regulate with the greatest efficiency because those agencies are already in existence and are familiar with the problems which arise in the course of public regulation. Congress has already provided for the utilization of State Commissions in its authorization of co-operative procedure and the use of the services and facilities of such Commissions in carrying out the purposes of the Interstate Commerce Act. In the Selective Draft Cases and related cases[9] the Supreme Court of the United States has held that the act was not void as a delegation of Federal power to state officers who acted in an administrative capacity on draft boards. The way is, therefore,

[8] 257 U. S. 563, 66 L. ed. 371, P.U.R.1922C, 200, 215, 42 Sup. Ct. Rep. 232, 22 A.L.R. 1086.

[9] 245 U. S. 366, 62 L. ed. 349, 38 Sup. Ct. Rep. 159.

open by which Congress may, while occupying the field within which it has jurisdiction, keep the regulation of commerce close to the people.

Whatever conclusions the Federal Trade Commission and the Senate Committee may reach in regard to legislation and whatever recommendations may be made to Congress, the State Commissions should be prepared to recommend such changes in their laws pursuant to a uniform plan as will retain regulation.

LEGISLATION by Congress at this time should go no further than to provide that holding companies be defined as "public utilities" and made subject to regulation for the purpose of ascertaining the actual costs and benefits in rate cases coming before the State Commissions; that these Commissions may exercise jurisdiction over security issues of these and other interstate public utilities within their respective states, and that the Commissions may exercise authority to require the production of all records of the outside holding company which bear upon the relationship or that company to the local utility.

It is believed possible for most State Commissions that have broad general power to regulate a holding company, within the rules now laid down by the United States Supreme Court, which actually exercises control of management and operation of an operating company or companies within its jurisdiction by regarding the two as one and the same—in other words, by disregarding the corporate fiction.

Much of the difficulty lies in the fact that many of our State Commissions have not assumed to exercise many obvious powers which they possess over these holding companies, and which can be enforced by appeal to the courts when necessary.

It should also be borne in mind that the Supreme Court has laid down the rule that while a State Commission may not regulate interstate power, natural gas, and water at its source, it can nevertheless regulate it at the points of delivery.[10] Moreover, it has laid down the rule that while the states may not interfere with interstate stage operations, they can apply adequate road taxes, require indemnity bonds, grant or deny right to operate intrastate, and provide for regulation of local rates and services,[11]—all of which is seemingly necessary for the time being.

CONTINUED private operation, under the regulation of State Commissions, seems to be the best possible method of handling public utilities. It is merely a matter of working out a problem connected with state control rather than the abolition of it and the substitution therefor of added Federal supervision of local matters.

There is the alternative of strengthening state regulation or of the centralization of control in some Federal department. The former is preferable and the latter should not be considered unless it becomes absolutely necessary.

[10] Pennsylvania Gas Company *v.* Public Service Commission (1920) 252 U. S. 23, P.U.R.1920E, 18; Public Utilities Commission *v.* Attleboro Steam & Electric Co. (1927) 273 U. S. 83, P.U.R.1927B, 348.

[11] Motor Vehicle Cases—267 U. S. 307, P.U.R.1925C, 483; 267 U. S. 317, P.U.R. 1925C, 488; 235 U. S. 610, 622; 242 U. S. 160, 167; 266 U. S. 570, 576, P.U.R.1925C, 231; 271 U. S. 583, P.U.R.1926D, 483.

The Man Behind Steps Out

A STUDY IN PUBLIC RELATIONS

The "soulless" utility corporation is emerging as a humanized corporate entity that is assuming the personality of its leader.

By IVY L. LEE

EFFECTIVE publicity must have a purpose. To be thoroughly sound and constructive, it must be generated by a definite policy and be a reflection and expression of that policy.

Contrary to superficial impressions, publicity envisages far more than a collection of clippings. It also calls for something more substantial than the ingenuity to devise spectacular "stunts" or prepare intelligent statements for publication. Fundamentally, it is policy which counts in the public relations of a business enterprise or the advancement of a philanthropic, social, or economic program.

PUBLICITY is one of the instruments in achieving any stated policy. It is a means by which an individual, a group or some definite principle is presented to the public. Publicity is as old as the ages, but, in common with much of the progress the world has seen in the past three decades, it has become highly specialized, rapidly developed and, in some cases, falsely exploited. If there is not actual overproduction of poor or mediocre publicity, it is a fact that too often sound publicity technique is ignored or entirely disregarded. Too often publicity becomes not the means to an end, but an end in itself, and it is this misconception which might profitably be clarified by more frank discussions of publicity itself.

Publicity is an impulse that tends to perpetuate itself. Whether good or bad the influence of publicity constantly grows.

THERE can be little doubt that the present attitude of American business and American business leaders today, and the evolution of our present business technique have resulted in part at least from publicity. It is also true that our present extraordinary economic advances have been made since constructive publicity was substituted for the blind and vitriolic outbursts that were so popular after the turn of the century. In those early years of the twentieth century, it was felt that if public opinion

were to be considered or influenced in any way, it was necessary to employ devious methods of approach through the press or manipulate public officials and others occupying positions of authority.

One of the first impressions vividly stamped upon my mind when I undertook my present profession was how difficult it was at that time to find the sponsorship or authority for various types of publicity which were then current. I believe now, as I did then, that those who pursued such methods had only a partial and faulty understanding of sound publicity technique. That kind of publicity was highly objectionable and, in the main, irresponsible. It has long since been abandoned by those who recognized the proper place that publicity holds in the expression and evolution of a definite policy.

Ever since the futility of such technique became apparent it has been fundamental in sound publicity activities that every statement to the public should carry the name of the individual, organization, or group in whose behalf such a statement is prepared. This assures responsibility which is one way of applying the principle already stated. In the long run frankness is the only attitude by which a real public support can be built up and maintained.

WHEREVER the public is involved —and what form of activity these days does not touch the public at some point—it is a vital necessity to consider the public interest and, in the light of all known facts, to present that policy or subsequent steps in its application to the public in a perfectly frank way. In these days the search for competitive advantage is too keen for any individual or group to proceed long without the support of public confidence which is essential to success.

IN the utility field, public relations are even more important because of the continual, close relationship between producer and consumer. An intelligent understanding of service must be maintained. Publicity is helpful in broadcasting the achievements of successful leaders and companies that are building with an idea to the future. It has been a necessary aid in promoting a better understanding of the essential public service of utilities. Most interesting of all is the success with which publicity has enabled the utility industries and others to personalize themselves.

Big business moves forward on still bigger lines and in greater volume than ever, but it is not paradoxical to see a great enterprise launched or merged on the personal achievement of a single individual or the combined achievements of his colleagues. Undoubtedly there is a saturation point beyond which corporate units cannot successfully be maintained, but we are now realizing that physical size is less a factor than the degree with which such units can adequately and continuously reflect the personality of their chief executives.

HAPPILY, the old doctrine that corporations were formed as a convenient means for distributing responsibility is yielding to the new and more intelligent concept that corporations after all are human.

Outstanding Successes Among Utility Companies Assume the Personalities of Their Helmsmen

"ANYONE who would appraise the public utility industry today must be at once impressed by the influence which its outstanding leaders have had and the success with which they have left their personal imprints, not only in individual companies but upon the industry itself.

"THERE are the Vails, Edisons, the Youngs, whose success and influence entitled them to high rank in this industry, and they have their colleagues and counterparts in every other field of business and finance."

Their framework may be impersonal, but the energy and the forces which make them successful are most decidedly human hands and human minds. The popular conception of a company, therefore, is very often reflected in the esteem and popularity of its major executives whose business it is to represent it to their public quite as much as to administer its affairs in the interests of stockholders and employees.

Even the most casual glance at the American industrial field will impress the observer with the fact that there are few companies today that are truly impersonal in character. Almost without exception the outstanding successes are the ones which have leaders who have stamped their personalities upon the public as the personality of their own company. These leaders have created a new sphere, the sphere of *business statesmanship*. This is one reason why the sting of the cartoonist has been drawn and we no longer see the business interests of a community lampooned in an exceedingly *naive* simplicity as massive, coarse, and gloating monsters seated on piles of gold or the broken bodies of widows and orphans.

The public conception of corporate business has outgrown this childish myth, mainly because of business statesmanship. Anyone who would appraise the public utility industry today must be at once impressed by the influence which its outstanding leaders have had and the success with which they have left their personal imprints, not only in individual companies but upon the industry itself. There are the Vails, Edisons, the Youngs, whose success and influence entitle them to high rank in this industry and they have their colleagues and counterparts in every other field of business and finance.

IN the last decade the public utilities of New York city have presented examples of outstanding success, in building sound and intelligent public opinion and public support for utility policies. As an example of this, it is necessary only to cite the success of

J. S. McCulloh, president of the New York Telephone Company, whose ability to direct the company's public relations in a critical period following the World War was a clear case of frankness with the metropolitan public.

Among the innovations which Mr. McCulloh has introduced since he became president of the company is the series of conferences with executives of large subscribers who are invited to headquarters to ask questions, criticise, suggest, and inspect the company's equipment there. Mr. McCulloh's sound reasoning for this policy has been set down by him as follows:

"I believe that today management must be more alert than ever before. It must be aggressive in the best sense of that word and find out exactly what the customer's attitude is. Suggestions should be invited not only by the management itself, but by all representatives of the company. Salesmen, for example, who come most frequently in contact with customers, should be trained and stimulated to find out by careful questioning and investigation, exactly what customers are thinking and saying about the company and its product. We find that frequently our customers give us most valuable suggestions when we give them ample opportunity to talk to us. Another method of obtaining such information is by the group or conference meeting such as we have carried on for the last three years with executives of various business concerns of New York city.

"It might not be practical for the president of an automobile company or a vacuum cleaner concern to gather together groups of his customers periodically and ask them what is wrong with his business. But I do believe that the management of any company would be far better informed if they made occasional trips out on the road or took some other similar method of getting and keeping in close touch with the final users of their product. Complaints have always seemed to me to be important. If they are handled in the right way they become suggestions for better service. I have heard of many incidents in manufacturing companies in which the president asked to have all complaints which came into the factory go across his desk. Through careful study of complaints some companies have developed new products, made a change in service, or in a method of billing, and in other ways improved public relations. I know that in some of the great organizations when an unusual complaint comes into the office and has been handled by a chief executive of the company, the complaint has been broadcast through means of the employee magazine. I remember in one such case when the president of the Cadillac Motor Car Company answered a complaint concerning new models from one of his customers and then issued the letter and the answer, together with the customer's final reply in the form of a broadcast to all of the organization.

"In another incident I remember where a president handled a suggestion and a letter from a man who had come to be called a 'nut' customer among the members of the service department. This incident resulted in a totally new product being made by the company which later on became the main item and a large profit-maker. Handling a complaint in a sensible manner, bringing it immediately to the attention of someone who has authority to change policy, is merely one way of keeping the ear of the management close to the ground."

MATTHEW S. Sloan, president of the New York Edison Company and affiliated companies in New

York city, is another conspicuous example of utility leader who has built up a large public support based upon frankness. Frequent personal messages, directed to the thousands of subscribers who use his service, have enabled him to instill a confidence and support that would be entirely lacking if he felt that the public did not like to know what his companies were doing and could not be made to appreciate service.

It is work of this type in the public utility industry, and in other industries, that is helping the American public to get a better understanding of business; it has helped maintain more cordial co-operation between employer and employed; it has paved the way for exceptional diffusion of stock ownership. In a word, it is one of the instruments that has helped this country to rapid economic development and the present prosperity.

No longer is "big business" a malevolent ogre. "Big business" and "little business" are intensely human and personal things. How long they will remain human and reflect the personality will depend very largely upon the skill and foresight with which their present leaders continue to leave the imprint of their personality, on the record of industrial progress in this country.

Believe It or Not

(By our own Ripley)

Out of every dollar of telephone operating expenses, 54 cents go for wages, 17 for materials, 11 for taxes, 3 for rentals, and 15 for miscellaneous expenses.

* * *

The physical strength of a strong man, in terms of horsepower and in comparison with a modern electric motor, is worth from six to fifteen cents an hour.

* * *

At least 15 per cent of all of the power generated by central stations throughout the United States is "lost" somewhere between the power house and the customers' meters.

* * *

Chicago leads the world in the *per capita* use of electricity.

* * *

New York sells more gas in an average quarter than all of Italy in a year.

* * *

Nebraska has the largest number of municipal light and power plants of any state in the Union—248.

* * *

Only one passenger out of every 280,000,000 carried was fatally injured on electric railways of the United States last year.

* * *

To relieve traffic congestion a new 29-story automatic skyscraper garage which will hold 1,000 motor cars, has just been completed in Chicago.

* * *

One person out of every twenty in the United States is financially interested in the welfare of transportation supplied by electric railway managements.

* * *

The Hanover telephone exchange in New York is said to be the busiest in the world, handling as it does a large part of the financial business in the Wall Street District.

THE ETHICAL AND LEGAL RIGHT TO VIOLATE

Rates Assured by Franchises

Why has it come about that contracts relating to prices charged to consumers are not binding on every party—including the state?

By ELLSWORTH NICHOLS

Opponents of a new franchise proposed for the operations of the Pacific Telephone & Telegraph Company in Seattle have strenuously insisted that any franchise granted to the company should contain a clause restricting rates.

This demand has been met by assertions that rates are subject to regulation by the State Commissions and that rate provisions no longer have any place in a public utility franchise. To quote the words of Mayor Frank Edwards, as reported in the Seattle *Daily Times:*

> "This franchise does not affect the rate question in any particular. It could not. Every lawyer and most laymen know that. State law gives the Department of Public Works control over rates and service and the council or any twenty-five citizens can initiate proceedings. They could initiate such proceedings if the ordinance were filled with rate agreements. The city cannot by any device override state law."

The right of the Commission in the state of Washington to change rates restricted by franchise was sustained by the supreme court of Washington in the year 1912.

The Commission had authorized an increase in telephone rates in the city of Seattle, notwithstanding the existence of a franchise limiting the rates. Chadwick, J., in an extended opinion, announced the rule that the legislature, in the exercise of the police power of the state, could authorize the Commission to change these franchise rates, and it was held that such power had been delegated to the Commission.[1]

The Washington situation seems to be the same as in other states where Public Utilities Commissions regulate rates and where power has been conferred upon them to change rates fixed by contract—and a franchise is a form of contract. The Supreme Court of the United States has upheld the right of a state to disregard rate contracts when public interests will be benefited by such a course.

The development of this rule is interesting and it has been misunderstood by the public generally. We have always been told that a contract is protected by constitutional safeguards. Breaking a contract is not considered a respectable thing to do.

How, then, we may ask, has it come

[1] State ex rel. Webster *v.* Superior Court (1912) 67 Wash. 37, 120 Pac. 861.

about that contracts relating to rates are not inviolate and binding on every one, including the state?

PRESENT critics of the practice of deviating from the terms of a rate contract are usually found in the ranks of those who would prevent public utilities from increasing rates, because, since the World War, prices have steadily risen and rates fixed by franchise before the war have turned out to be inadequate.

The public utilities have been attacked for not "sticking to the terms of their contracts."

Commissions have been condemned for increasing contract rates.

Courts have been called "tools of the interests"—that choice phrase of demagogues—for not upholding the "sacred obligation of a contract."

Critics of this sort who are not familiar with the history of the subject would be surprised to learn that it was not the public service corporations, but the antagonists of these companies, who first advocated the doctrine that contract rates are not immune from state control, and that it was the representatives of the ratepayers who secured judicial recognition of that doctrine. This is, nevertheless, the truth.

PRIOR to the year 1870, competition had been the regulator of rates, but in the following decade the legislative power was invoked, particularly in the Middle West, to bring the carriers under public control. This was called the "Granger Movement."

The farmers were complaining of high and discriminatory rates and their organization, the National Grange, carried the banner in the war on rates. The Supreme Court, in the famous Granger Cases, upheld the right of the states to regulate railroad rates. There were eight of these cases, all involving laws of either Illinois, Iowa, Minnesota, or Wisconsin. In these controversies the railroads advanced (among other arguments) the contention that they had been granted power in their charters to regulate rates and that any law attempting to deprive them of this power would be unconstitutional as impairing the obligation of the contract with the state arising from the charter. It had been decided in the Dartmouth College Case, contested in the Supreme Court by Daniel Webster, that charters are contracts. The Court, in the Granger Cases, held, in effect, that the charter rights conferred did not carry with them a renunciation of the superior right of the state to regulate, in the absence of an express intention shown by the state specifically to renounce this right.[2]

The first battlegrounds of the contract war were cleared when the right of the state to regulate railroads notwithstanding charter provisions was sustained. The issue had been forced by the public and rates had been reduced. Next came the contest over franchise rates, and here again, building upon the foundations laid in the railroad rate cases, the forces favoring rate reduction were victorious in establishing the principle that rates fixed by franchise could be changed by public authority.

[2] Peik *v.* Chicago & N. W. R. Co. (1876) 94 U. S. 164, 24 L. ed. 97; Chicago, B. & Q. R. Co. *v.* Iowa (1876) 94 U. S. 155, 24 L. ed. 94; Winona & S. P. R. Co. *v.* Blake (1876) 94 U. S. 180, 24 L. ed. 99.

Where the Doctrine Originated for Disregarding Rates Established by Franchises

"THE *public utilities have been attacked for not 'sticking to the terms of their contracts.'*

"COMMISSIONS *have been condemned for increasing contract rates.*

"COURTS *have been called 'tools of the interests' . . . for not upholding the 'sacred obligation of a contract.'*

"CRITICS *of this sort who are not familiar with the history of the subject would be surprised to learn that it was not the public service corporations, but the antagonists of these companies, who first advocated the doctrine that contract rates are not immune from state control, and that it was the representatives of the ratepayers who secured judicial recognition of that doctrine. This is, nevertheless, the truth.*"

IN beginning operations in a town or city, gas and electric light utilities and street railways must obtain franchises permitting them to do business. These franchises, in the early days, usually contained provisions either limiting rates to a stated maximum or fixing a specific rate.

As the industries developed and costs went down, consumers wanted lower rates than those allowed in the franchises. The public utility companies pointed to their franchises and insisted that they were entitled to charge the rates set forth. The point was tested and in numerous cases the state, acting through a Commission or other rate-fixing bodies, reduced rates below those permitted in the franchise. Here again, as in the case of railroad charters, the basis for the disregard of franchise rates was the proposition that the state, in the exercise of its police power, has the right to regulate public utility rates. Starting with this foundation, the principles were developed along the following lines, briefly stated:

In some states the legislature is prevented by the Constitution from divesting itself of the power to regulate rates, and, therefore, no municipality could claim the right to fix rates irrevocably by franchise.

In other states, where the legislature has the power to divest itself of the rate-making control, there must be a plain intention shown to confer the rate-making power upon a municipality, and unless such power is shown to be delegated, the municipality cannot enter into an irrevocable franchise contract fixing rates.

As stated on one occasion, a mu-

nicipality has no power to limit by contract its rights to regulate rates of public service corporations unless expressly authorized, and the authority to make such contracts cannot be upheld by mere implication but must be clearly and unmistakably shown.[3]

THE principles thus established were hailed as victories for the public, and an inspection of the cases shows that they were applied for many years almost invariably to reduce rates. Then, when costs began to rise and the public utilities appealed to the Commissions for authority to increase rates fixed by franchise, the shoe was on the other foot, and attacks upon these principles by representatives of the public were begun.

It may seem to some that this is an instance where the public had put across an idea which later reacted as a boomerang; but the courts, in insisting that the rule shall apply both ways, have not actually done the public harm by strict adherence to an established legal principle in cases where the companies have needed additional revenues. Public utilities exist primarily for the service of the public and the refusal of rates which are sufficient to maintain such service would mean impaired service, and perhaps bankruptcy, with consequent detriment to the community.

This is illustrated in a case which came before the New York Public Service Commission. The New York State Railways was operating in the city of Rochester under a 5-cent franchise fare. The New York courts had held that no power had been delegated to the Commission to increase fares fixed by such a contract. Repeated requests had been made to the common council and other authorities of the city for permission to charge a greater fare than 5 cents, which had at all times been denied.

Service was admittedly inadequate and the question was presented whether the company should be required to improve its service. The Commission declined to require the company to improve service where such increased service would increase the expenses of the company, as the service was already noncompensatory and it was not within the power of the Commission to remedy the rate situation. Patrons, therefore, were deprived of adequate service until, through an agreement between the city and the traction company, higher fares were finally effected.

THE great obstacle to the fixing of rates by franchise is the fact that conditions are not always the same but are continually changing. This is shown by a case before the Oklahoma Commission where it appeared that a gas and electric company had accepted a franchise providing that the minimum charge should be $1 per month for each kilowatt of lighting capacity and $1 per month for each horsepower of power capacity. Many industries put in motors for the operation of their business in Oklahoma City with the expectation that the near future would bring an increase in business. This development did not materialize; hence motors with greater horsepower capacity than was necessary to operate the plants had

[3] Home Teleph. & Teleg. Co. *v.* Los Angeles (1908) 211 U. S. 265, 53 L. ed. 176, 29 Sup. Ct. Rep. 50.

been installed and were in use. Commissioner Henshaw, in ordering a reduction of minimum charges, said:

> "Whether the minimum rate provided in the franchise was reasonable depended upon the conditions that existed at the time the franchise was adopted by the people. The Commission must now determine the reasonableness of this minimum rate under the conditions and facts disclosed by the evidence in this case." [4]

The plain purpose of the legislatures in authorizing Public Service Commissions to regulate rates is, as stated in a Massachusetts decision relating to electric railway fares, to prescribe for the regulation of rates throughout the state by a single public board which may be expected to act with a broad and unbiased view for the promotion of the common good of all the conflicting interests involved and not under the influence of purely local considerations. The Massachusetts statute was said to be a legislative determination that it is unwise and inexpedient longer to permit the full development of interurban transportation by electric railways to be hampered by conditions as to fares contained in locations granted by the public officers of different municipalities.[5]

These franchise contracts are not void, and when the state refuses to intervene they are upheld, but the public interest is so great that the courts refuse to accept the doctrine that a municipality has an absolute right to fetter the public utilities so that the state, in its discretion, cannot establish rates which will enable the company to fulfill its obligations to the public.

[4] J. I. Case Plow Works *v.* Oklahoma Gas & E. Co. (Okla.) (1915) P.U.R.1915B, 183, 191.

[5] Arlington Board of Survey *v.* Bay State Street R. Co. (1916) 224 Mass. 463, 113 N. E. 273. Cited in Bay State Rate Case (Mass.) (1916) P.U.R.1916F, 221, 236.

Conflicts between the Courts and State Commissions in Valuation Cases

"TOO *often the courts have been disturbing the reasonable judgment of State Commissions arrived at after a consideration of all the evidence.*

"I have the highest respect for our Federal courts, but it appears incredible to me that state regulatory Commissions are always wrong in their judgment of the evidence in valuation cases. The Indiana Commission was created in 1913 and has yet to win a rate and valuation case in the Federal courts, although many such cases have been carried by the utilities to the Federal tribunals. In each instance the Federal courts have found that the Commission erred in fixing valuation and rates too low."

—HOWELL ELLIS
MEMBER OF THE INDIANA PUBLIC SERVICE COMMISSION

Remarkable Remarks

WHITING WILLIAMS
Industrial investigator.

"Today Guatemala, with few rail and fewer truck roads, has an airport almost as good as Detroit's."

MORRIS LLEWELLYN COOKE
Engineer and publicist.

"The country is not yet ready for any widespread public ownership."

SIR HENRY W. THORNTON
President, Canadian National Railways.

"To make aircraft rival railroad or steamer it would be necessary to insulate the aircraft against gravity."

G. J. MACMURRAY
News editor, "Electric Railway Journal."

"The private motor remains the most serious competitor of the co-ordinated services. Buses no longer are considered as serious competitors."

WOODROW WILSON
(*In an address made in 1915 to the American Electric Railway Association.*)

"There are a great many businesses in this country that have fallen under suspicion because they are so secretive when there was nothing to secretize that was dishonorable."

H. I. PHILLIPS
Newspaper columnist.

"Mr. David Sarnoff, just made president of the Radio Corporation of America, came to this country as an immigrant boy. That's what is meant in radio circles by getting distance."

MABELLE JENNINGS
Newspaper columnist.

"Will it make you any older to know that Owen D. Young, when occasion demands his presence in Washington, always has reservations on every New York bound train the day of his departure?"

WALTER WINCHELL
In his newspaper column "Things I Never Knew Till Now—."

"That you can sleep in the Pennsylvania Stations in New York all night by purchasing a 15-cent ticket to Newark, and turning it in, after your nap, you can get back your money. (The Pennsy people will love that.)"

Statement from a press release of the Socialist Party.

"The Republican party, which in the New York city election gave its usual exhibition of incompetence and collusion with Tammany, is now giving in Albany its usual exhibition of service to the power trust and other vested interests, yielding only partially and grudgingly to overwhelming demand for decent legislation for the general welfare."

THE UNSOLVED PROBLEMS OF REGULATING

Interconnecting Companies

NUMBER I

THE process of co-ordinating electric lines is based upon sound economic principles which are commonly applied to other industries; the financial consolidations of the electric corporations have followed in due sequence. The more recent introduction of the holding and management corporation injects still another factor into the task of regulating these utilities, which are extending beyond the state borders and thus passing from jurisdiction of the State Commissions. This article—the first of a series—presents the problems with which the utilities and the Commissions are being confronted and which sooner or later must be met.

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INTERCONNECTION of electric utilities is primarily an economic undertaking. Its immediate object is to lower costs by production of an economic good at less monetary outlay than was formerly required for the same production of equal quality.[1] The theory underlying interconnection is based upon economic principles of production which are commonly applied in other fields of business.

THE first of these principles which underlies interconnection development is that of diminishing costs. Under its operation integration of production units in a given business will, up to a certain point or size (other factors not interfering), result in decreasing costs per unit of product therefrom.

Operation of this principle in the field of electric energy supply produces a tendency toward larger size generating units in order to take advantage of their lower fixed costs. This progressive growth in size of production units has continued since the inception of central station generating practice in 1882.[2]

[1] This immediate purpose of interconnection, however, is not an end in itself. The ultimate aim must be the making available to an increasingly larger number of human beings the advantages and comforts which will accrue from cheaper and more abundant electric energy. In other words, to the business man interconnection and interchange of energy among utilities signify the effecting of economies and stabilizing of dependable, continuous service which eventually results in lower costs to the companies; to the economist, however, interconnection must hold a social significance.

[2] The first central stations to be installed were (1) the Pearl street station, opened in New York city on September 4, 1882, with a maximum capacity of about 750 kilowatts, and (2) the Appleton, Wisconsin, station opened about September 30, 1882, the first being a steam station and the latter driven by water power from the Fox river. The size of stations increased continually from this beginning, there being in 1890 hydroelectric units of 5,000 horse power introduced by the Niagara Falls Power Company which began its developments in that year. See trans., *First World Power Conference*, Vol. 1, "Power Resources of the Central States," by Samuel Insull, p. 499, and in the same volume, "Power Resources of the Northeastern States," by John W. Lieb, pp. 536–8.

In the early years of electricity supply, application of this principle was largely restricted within the limits of a local consumption area. Where electric energy could not be carried far from its point of production, economies of mass production were necessarily limited by maximum energy demands of a local load center. Whenever such load center increased its maximum energy demand, it thereby became possible ultimately to apply the principle of diminishing costs by erecting the larger facilities required to meet the increases. Savings thus realized appeared in the smaller amounts of capital required per kilowatt unit of capacity and in lower operating charges incurred in larger, more efficient stations. The significance of interconnection for this type of economy depends upon the maximum time use to be made of concentrated station capacity.

It is, therefore, in conjunction with a second and perhaps more important economic principle that diminishing costs become economically important in interconnection. This may be called the principle of diversity economy.[3] It involves the advantage of transmitting energy from one place of excess production capacity to another of deficient or relatively uneconomical production, or between two stations of differing costs of generating, where differences in the occurrence of peak load periods allow more efficient stations to supply energy to less efficient ones. This has been made practicable by efficiency attained in power transmission.[4]

Operation of these economic principles is the theoretical basis for savings which may be expected from interconnection of electric utilities.

Upon this basis of electrical production theory, interconnection is gradually being developed. That theory is, however, no innovation in the field of electric energy supply.

"The interconnection of power stations within the limits of a city has been considered desirable practice since an electric utility system was big enough to have two stations within practicable distance of economical transmission."[5]

Opportunity for applying these economic principles to the field of electric supply interconnection in any specific location depends upon several prerequisite conditions. One is the existence of generating facilities and load centers within economical transmission distance of one another. This condition is becoming less of an obstacle to interconnection economy as the art of transmission becomes more perfected. When total costs of power transmission between two production areas gradually decrease because of improved technical methods, transmission of energy is more economical than generation of power in each of the two areas. This advan-

[3] This idea is expressed as "the saving made by interconnecting generating stations whose peak loads are reached at different times, and so distributing the load among stations of different unit operating costs as to deliver power at a minimum cost." W. S. Murray, "Superpower—Its Genesis and Future," p. 8.

[4] The origin and early development of high tension transmission of electric power are presented in detail by A. H. Markwart and H. A. Barre in trans. *First World Power Conference*, Vol. 1, pp. 564–613, 571.

[5] H. B. Gear, in "System Interconnection," *Electrical World*, November 6, 1926, p. 959.

tage is increased in favor of interchange of energy when load demands of one or more of these consumption centers outgrow capacity of generating units in the localities.

The demand for energy in a particular area may come to exceed the maximum capacity to which it is economical to enlarge existing stations. Economic considerations, such as limitation on water supply and available power station sites, may render this area financially unadaptable to larger power production. Thus, although the load continues to increase, it may not be desirable to expand generating capacity centrally located to the load. The economic alternative is rather to obtain energy from a locality within transmission distance where conditions of production are not developed so nearly to their physical limits or their margin of cost relative to other sources of substitute energy and where surplus capacity of large, new, and efficient stations may effect materially lower costs than would be necessary in an older region.

The meaning of this development is that the older and high load area has been displaced in production economy by another area where water and site requirements are less expensive, and where efficiency of maximum capacity stations provides a special inducement for interconnection.[6]

Such planning of energy supply has been more characteristic of electric utility development in urban areas than in regional territories. This has been due to growth of loads in established generating districts and to expansion of demand areas to newer places of both domestic and industrial use. It has resulted in savings both in costs of energy production and in reserve capacities of two or more such localities. The advantage to be gained by mobility of energy between such areas lies:

First, in differences in efficiency between two or more plants as measured by their costs per kilowatt-hour.

Secondly, in the use diversity (which may be defined as variation from each other of the peak load periods of two or more systems).[7]

This advantage is diversity economy; it is the saving which may be obtained by utilization of high reserves of one station at its off-peak period by another whose peak occurs at that time. This may be because the latter station is deficient in its capacity relative to its own peak, or because it desires to avail itself of neighboring off-peak reserve on account of cheaper production expense of that energy source. In this manner, the principle of diminishing costs in large scale electric generation and

[6] "In the larger cities, the situation at present (and for the future it will be much aggravated) is that the stations built in earlier years, to be somewhat central to the load areas supplied by them, have not reached their maximum possible size due to water conditions, area of load available or other causes, and cannot be developed further. Nevertheless, the load in the area to which these stations are nearest continues to grow apace, and provision must be made to produce this excess of energy in a newer station more remotely located. This at once calls for tie-lines of the largest practicable capacity between the station where additional capacity is being provided and the station in which excess load is being added." H. B. Gear, loc. cit., p. 959.

[7] The term "diversity factor" of demand loads means that percentage of deviation which two or more load curves show relative to each other.

A Proposal to Cloak the State Commissions with Federal Authority

"A proposal has been that State Public Service Commissions be authorized to act in the capacity of Federal bodies clothed with Federal authority when considering interstate problems. . . . It is considered that such legislation would not be held unconstitutional for the reasons that:

"(1) The policy is but an extension of present Court interpretation and;

"(2) Congress would not be dividing its purely interstate jurisdiction with the states but merely allowing them a temporary power over interstate matters of local significance subject to Congressional decision to revoke this control."

the preferred use of energy from such low cost stations, and the principle of diversity economy, by means of which reserve capacities arise from divergence of peak periods or from a temporary excess of capacity in a large new station the peak demand upon which has not yet nearly approached its maximum capacity, make possible a saving through interchange of energy over interconnections.

Although (as above stated), this exchange of energy has been more typical of urban areas, the general interconnection trend now includes tying together utility systems that serve different urban centers and intervening territories. Its purpose is to make it possible for electric utilities to obtain energy at most efficient sources within an interconnected system, considering transmission costs necessary to deliver such energy.[8]

Mobility of electric power between points of consumers' demand and generating areas of differing efficiencies permits a practice that may be, and has been, called "pooling of supply." This phrase in interconnection usage implies "the use by all of the available reserve capacity" of several systems.[9]

Pooling constitutes merging of total capacities of individual companies in order to determine and to make available to any having deficiencies below system average reserve, a part of all of surplus capacities of the others which from day to day show excess capacity over the system reserve.[10]

[8] "By making an investment per kilowatt-ampere in tie-lines of something less than the cost per kilowatt of capacity of the power station we can make available in either of the stations so interconnected the surplus of reserve capacity of the others." H. B. Gear, loc. cit.

[9] "Interchange of Energy," E. J. Fowler, loc. cit., p. 208.

[10] The subject of pooled capacities is not examined fully here but it is sufficient to state that two outstanding examples of pooled interchange systems exist, both of

In interconnection, pooling of system reserve capacities for use of energy from most efficient points of generation is conducive to maximum economy. Interconnection has, however, rarely reached a point of such efficiency. Although scores of physical interconnections have been made, and new ones are rapidly being added throughout the country, practically all of them are based upon surplus and emergency exchanges of energy in times of break-down or of overhauling generating facilities.

A tendency toward more extensive use of the pooling type of interconnection has been apparent in the last two years.

THERE are several reasons for absence of wide use of pooled generating capacities in interconnections. One is that interconnection and interchanges of energy have hardly been in existence long enough to reach the degree of perfection which pooling agreements require.

Interconnection was begun in a vigorous way only after the war. It is not to be expected that so complex an undertaking could be perfected in so short a time. Another reason serving to regard pooling has been divergent ownership and control represented by the many utilities concerned; a third is in difficulties of reaching agreements as to rate policies on interchange of energy and to systematic expanding of generating capacities. This latter consideration is vital in the general system program of locating new, more efficient capacity in those sections of the territory most favorably located with reference to growth of load centers as well as with regard to water supply and appropriate site.[11]

A fourth obstacle to interchange pools has been the difficulty in justifying the costs of interconnecting transmission lines in terms of savings compared with costs of energy in local stations.

ALTHOUGH, as formerly indicated, technical problems of interconnection are now being successfully met, the economic problem of making individual interconnections profitable is yet to be solved.[12] It consists in utilizing for base load the cheapest power sources in a system area twenty-four hours a day by means of interchange agreements, and in building demand loads so as

which have been in existence about two years. One is the interchange agreement among three electric supply companies in the Chicago area, the Commonwealth Edison Company, the Public Service Company of Northern Illinois, and the Northern Indiana Gas & Electric Company. The second is a similar interchange agreement based upon a pooling of generating capacities among three companies in the Connecticut river valley, known as the Connecticut Valley Power Exchange.

[11] This subject of relations existing among utilities parties to an interconnection agreement as affecting practicability of arranging an interchange of energy on a pool basis is well exemplified by the Chicago area interchange agreement referred to in the preceding note. The three companies concerned are under the same financial control although they are distinct in their corporate and financial structures. In conversation with an official of the Edison Company the writer learned that problems of estimating and directing in advance the construction of new generating capacity to meet future expansion of load centers in the interconnected system are much facilitated by the close relationship existing among the companies. This fact materially aids in the economizing of capacity investment as well as of operating costs beyond that possible in an interconnected system whose capacity growth is not thus directed.

[12] See E. W. Lloyd, *Public Service Magazine*, September, 1926, p. 105.

to make use of total capacity during a maximum number of hours. In this manner the capacity factor will be raised and total investment more economically employed.[13]

By this practice of pooling production capacities in an interconnected electric power system, cheapest energy may be utilized first as base load in preference to more expensively generated energy and also diversion of emergency energy may be made in case of seasonal or other needs, thus helping to assure steady, dependable service. Pooling is thus important for cheap power and for extension of load centers which will justify expensive interconnected systems.[14]

THE economic theory underlying interconnection and interchange of energy among electric utilities considered above has had special reference to local interchanges where definite objectives and advantages are had in mind. Application of this theory to wider areas of interconnection such as superpower regions presents problems each of which is in itself a subject for research. Although this study is devoted particularly to economies of energy interchange among individual utilities and to interchange contracts and energy rates used to secure these economies, it is intended to consider briefly here some of the issues involved in regional interconnection or superpower. This is done in order to clarify the subject of interconnection by stating some of the existing limitations upon superpower development.

As physical interconnection becomes more general, there arises a problem concerning eventual connection of all power resources of a region in order to take advantage to the fullest extent of interchange economy. It is in this aspect of transmission lines reaching over wide areas and connecting highly concentrated power generating localities into an energy interchange system that have been envisioned the possibilities of superpower and giant power. Such proposed undertakings include utilization of water powers and loca-

[13] Capacity factor is defined as the ratio of the average output in a given period to a maximum generating capacity in that period. Load factor is the ratio of the average load to maximum load during a given period. Capacity factor is considered a more reliable index of the economy of capacity charges in a system that is the load factor because the fixed charges which have an important influence upon energy costs are based on capital invested in capacity and not on the amount of power which customers take.

[14] The practice of pooling resources, although not yet common in electric interconnection, is not unfamiliar in some other fields of business. Considered merely as operation of the principle of diversity economy, it is applied in varying degrees to a number of businesses. Banking is a business in which utilization of this diversity economy theory has resulted in saving. Our twelve Federal Reserve District Banks, each drawing its capital resources from individual member banks of its district, hold aggregations of financial resources which are readily mobilized for credit relief in any regions needing it. This system of pooled resources has at least two distinct advantages;

(1) it frees smaller banking centers from maintaining high reserves, and

(2) it enables all reserve centers to extend credit to one another with greater mobility.

Inasmuch as seasonal credit demands upon individual banks tend to vary greatly, while for a region they show a fairly steady course, mobilization of resources and their ready transfer to any deficient areas cause a more constant relation between demands for credit and supply of it available at the time it is needed. The result is a stabilizing tendency in commercial rates of interest. The same principle is now becoming influential in shaping railroad organizations and traffic routeing. See F. G. Baum, "Technical Problems of High Tension Transmission," Trans., *First World Power Conference*, VIII. pp. 1115–1117.

Why the Proposed Regulation of Holding Companies Points to Federal Control

"If Federal regulation of an operating electric utility in its physical interstate character is initiated, extension of that regulatory authority to financing and management companies which control the operating units is rendered a more logical step. Such holding corporations are not now subject to regulation by state Public Utility Commissions. Their functions of holding securities and of drawing income from operating utilities in several states might justify extension of Federal regulation to them if it could be initiated in a field so obviously interstate in character as are interchanges of energy across state boundaries."

tion of steam generating stations at coal mines whenever these measures are economically feasible.

Determination of this economic practicability is, in most cases, the important prerequisite to initiating any such development in an active way. This decision will depend, however, upon dissimilar and varying factors in different localities. That fact renders difficult a general application of principles either as between two regions or within a single area.

Development of water power sites for transmission of hydroelectric energy through an interconnected system depends:

First, upon the "head" of water which a stream is capable of producing and upon regulation of stream flow or necessity of constructing water storage facilities, factors which materially affect fixed charges per kilowatt of capacity;

Secondly, upon distances which energy must be transmitted in order to reach nearest load centers of effective demand;

Thirdly, upon existence of steam generating facilities which can more economically be used when compared with hydroelectric energy in respect to total costs.

Stated in economic terms, practicability of developing a given water power site will be decided not only upon the first cost of producing units of energy therefrom, but also upon the expected life of such a productive agent and upon the anticipated subsequent trend of per unit costs of power at the same site, as well as upon relative costs of production at a possible substitute source of power.[15] It has generally been concluded that use of a specific hydroelectric generating location may be justified in conjunction with steam electric stations of high generating coal costs,[16] even though

[15] "Steam Power in Relation to the Development of Water Power," by Richard C. Powell, Engineer, Pacific Gas and Electric Company, *Journal, A. I. E. E.*, December 1925, pp. 1291–1295.

[16] *Ibid.*, "The extent of development of a given site for much of the existing water power was determined by financial limitations which required a minimum first cost. The electric light and power industry today,

the hydro project because of transmission distance or original high cost could not economically be undertaken alone.[17] These along with other features of economic significance, such as profitable employment of water powers in collateral commercial uses,[18] combine to determine finally what power resources are most economically available for interconnection and transmission of energy.

CONSIDERED in this way, claims made for development of water power and mine-mouth electric generation must be judged on a basis of the most economical sources available to any particular load area. As in the case of hydroelectric sites, practicability of utilizing mine-mouth generating plants depends upon costs of energy from alternative sources of supply to load demands. Mine-mouth electric generation is not an untried business.[19] It has been determined, however, in certain situations that mine-mouth steam electric energy could not economically be carried over 150 miles in competition with coal transportation costs to steam electric stations located at load centers.[20] The practical economy of

however, is on the whole no longer forced to uneconomic practices on account of inability to finance properly. In other words the industry stands upon a free economic basis, and, hence, an economic study of any given water power project should include the costs of the next probable developments. It is evident, therefore, that most projects will on this basis be developed to a somewhat greater extent than if considered alone, for developments will naturally be selected in the order of cheapness. Carrying this idea to a conclusion, we are forced to a consideration of the least available water power which can be economically developed and finally to some other form of power, which is undoubtedly that to be obtained from burning fuel, which, at the present time, is steam power."

[17] George A. Orrok, Consulting Engineer, New York City, Trans., *A. S. M. E.*, 1923, Vol. 45, p. 559.

[18] One of the best examples of this is the utilization of water powers on the Pacific coast, especially in California. The opportunity which has been presented there profitably to dispose of surplus storage waters for irrigation purposes has had a material influence upon the economy of hydroelectric generation for which steam electric standby stations have had to be maintained.

[19] Mine-mouth plants are operated in the Pittsburgh district and in the Birmingham, Alabama, territory of the Alabama Power Company. Such plants are in operation in Southern Illinois by public utilities serving that area. Two of these are (1) the Muddy power station of the Central Illinois Public Service Company near Harrisburg in Saline county, and (2) the same company's Grand Tower station on the Mississippi river in Jackson county. All such plants are rarely found located adjacent to the mines for the reason that water is not always available in sufficient quantities at the mines during the entire year to supply a flow of 400 to 700 tons of condensing water per ton of coal required in electric generation. See "Mouth of Mine Plant," by W. E. Eberhardt, Trans., *A. S. M. E.*, 1925, Vol. 47, p. 406.

[20] This has been determined in two different localities. An engineering study made by Charles Penrose, Assistant General Manager of Day and Zimmerman, Incorporated, of Philadelphia, of the proposals outlined in the Giant Power Survey Report favoring mine-mouth steam generation in the Pittsburgh Coal region and transmission of this energy by means of 250,000 volt lines to the Philadelphia load center ("Giant Power Report," p. 149) showed that at coal prices in effect at the time of making the study, 1925, the advantage lay with coal transportation and electric generation at the load center, and that this advantage was owing not only to the prices of coal delivered at the generating center, but to increased economies which have been effected in coal consumption by public utilities per kilowatt hour of output. "Further Studies of Giant Power—Transportation of Coal versus Transmission of Energy," *N. E. L. A. Bulletin*, June 1925, p. 367. A second study conducted by W. L. Abbott, Engineer of the Commonwealth Edison Company of Chicago, reached a similar conclusion in comparing the detailed costs of electric transmission between the Illinois coal fields and the Chicago demand load. In Trans., *A. S. M. E.*, 1921, Vol. 43, pp. 429–36, Mr. Abbott says: "It must be admitted that during the past few years the railroads have done much toward popularizing electric transmission, but rates have not quite reached the point where even under the most favorable conditions in the Middle

utilizing such mine-mouth plants in an interconnected system depends in each case upon costs of the undertaking compared with present energy costs at the load to which it is contemplated to transmit energy.[21]

INCLUSION of mine-mouth and hydroelectric generating facilities is not necessary in order to effect an interconnection of electric utilities. Nevertheless, wherever they can be utilized in relaying energy over such connections they may increase economies. Superpower regions have usually signified ultimate development of hydroelectric and mine-mouth steam stations as sources of transmitted energy wherever those forms of generation are at all practicable. At the present stage of development, it is probable that general substitution of mine-mouth plants and hydroelectric stations on a superpower scale is not to be expected. Interconnection remains the most practical plan for interchange of power on an economical basis. Upon the progress of interconnections, now largely in their inception, rests the economic practicability of the wider undertaking known as superpower.

CONSIDERED in perspective, progress of regional interconnection of electric utilities for interchange of energy may be viewed as the parallel development of improved technical efficiency in power transmission and the growth and expansion of load centers which will demand and justify carrying of energy from localities of mass, low cost production to these load centers. The theoretical question as to whether electric interconnection should be pushed to a de-

West, a power company could be warranted in maintaining a power plant at the mine, a standby plant in the city, and a transmission line between. Conditions, moreover, are seldom 'most favorable,' as with us the large quantity of flowing water necessary for condensing in a plant of upward of 50,000 kilowatts is seldom found at the mines. This renders it necessary to ship the coal to a power house located on a nearby river and to transmit electrically from there to the place where the power is to be used."

[21] As an excellent illustration of this station, the Chicago interchange areas companies have constantly considered the economy of transmission of energy from mine-mouth plants as alternative to present coal transportation methods. The latest study of this problem for this area substantiates conclusions reached in other areas facing the same problem, that until the cost of coal shipped to the load center rises, relatively, to a point which will offset transmission charges and cost of maintaining emergency standby stations at consumption areas, the advantage lies with the energy generated in steam electric stations at load centers. In addition to these considerations, difficulties in securing abundant condensing water at mines, necessitating short distance coal hauls add to costs of the transmission method. The problem is thus recently stated: "The generation of electric power at the coal mines has been advocated for years in connection with the superpower development, but it is not the location of the coal that has determined our station sites, but the location of the power demand and the necessity of a very large supply of water for the condensers. It must be remembered that in any modern power station we pump through the condensers not less than 400 tons of water for every ton of coal burned, this to absorb the waste heat. There are few localities in this country where coal mines are adjacent to a plentiful supply of water, and in Illinois, on account of the geological formation, no coal operator would sink a shaft within several miles of the Illinois river. But the associated power companies of the Chicago district already own a large tract of land on the Illinois river within 150 miles of the city, which within a very few years will be developed to supply electric energy to the Chicago district over a 130,000 volt transmission line. Such an enterprise has not been warranted in the past because the cost of shipping coal into Chicago has been less than the cost of transmitting electric energy and it could not be justified at the present time except it be done in large units and at high load factor." "Electric Power Development in the Chicago District," W. S. Monroe, President, Sargent and Lundy, January 1926, pp. 18–19.

gree of perfection in advance of economic demand therefor, or whether economic considerations such as an assured time use factor should be guaranteed in advance of the construction of facilities to meet this demand, has been a point provocative of controversy. The issue has turned to a considerable extent upon the particular social points of view which writers on the subject have held; that is to say, proponents of the idea of business as solely a private, competitive enterprise for personal profit have held that expenditures for interconnections and their accompanying adaptations which may result in consumer benefits cannot be justified on a wide scale until there is assured a consumer demand sufficiently heavy to produce a fair return upon the necessary investment. Others have taken the position that interconnection and superpower should precede growth in consumer demand in order to make available cheap power at a price which will be a stimulus to that large consumption capacity which is not now being supplied, and which can become an active factor in demand only when the industry organizes its production methods so that marginal cost to supply any specific increment of demand coincides more nearly with marginal utility of that demand for the energy.[22]

It is unlikely that either of these theories alone can constitute a basis for approximately complete interconnection of electric power sources for the purpose of interchange of energy. As stated above, each must parallel the advance of the other in order to give sufficient basis for future development. Economically, the two factors bear to each other a relation of supply and demand; further progress in interconnection constituting the supply of electric service, and undeveloped capacity for its consumption being the demand influence. It is the attitude of electric utility management that density of interchange load demands over interconnected transmission lines must be heavy enough to support special capital outlay attributable to interconnection, less any saving it may effect.[23] This can be accom-

[22] This latter viewpoint is especially characteristic of that mode of thought which has found expression in the objectives embraced under the term Giant Power, as presented in the Pennsylvania Report. It is there argued that power generation should be concentrated in the area of cheap production under management distinct from that of electric transmission and distribution utilities, and that it shall be the duty of the last named utility corporations to procure the energy for the different types of consumer demand—urban lighting, urban power, rural lighting and power, and the other types of demand—at the cheapest source and deliver it at cost plus the necessary distribution outlay determined by the degree of service required by each demand. Thus, "In determining rates to be charged to the great majority of consumers, the manufacturing cost of the power itself has long since become of minor importance. Rates, especially to the smaller consumers, are largely based on what the industry terms 'the cost of service' and not on the cost of power. This situation appears to greatly retard a healthy and balanced growth in the use of electricity and prevents the spread of distribution lines especially to farming sections. Rural communities are not interested in 'service' demanded by city folks. Rural rates today are based on a level of 'service' which the farmers do not want and which is actually rarely furnished. The only logical answer appears to be a Giant Power industry through which power as a commodity is manufactured in enormous volume and then sold in bulk at cost plus a manufacturer's profit to any one capable of using a sufficient quantity as to warrant delivery." "Giant Power Report," p. 141.

[23] A. H. Markwart, engineer, Southern California Edison Company, in *Power Plant Engineering*, May, 1926, p. 600.

¶ "ELECTRIC *utilities are opposed to extension of Federal regulatory authority to their industry. This attitude is taken for several alleged reasons. One is the lack of understanding of local utility problems which a distant Federal agency may possess, compared with state control.*"

plished only when the contract and rate terms governing interconnections induce a ready flow of energy among companies at a cost to purchasing companies at least as low as the necessary cost in their own plants, and at a price to selling companies sufficient to cover their costs of generation and transmission.

IT must be recalled, however, that interconnection and interchange of energy contracts are, in all ordinary cases, agreements among companies which both buy and sell energy, and thus, rates, not being governed by monopoly conditions, are left to bargaining among the parties; that many benefits may accrue to the companies concerned in the form of continuity and dependability of service and protection in emergency periods, although for the time being the interconnection may not be financially profitable.[24]

In the case of an interchange agreement within an urban heavy load center savings will likely be found to offset special charges allocable to interconnecting construction, especially where a pooling of reserves increases economies. When interconnections exist among utilities of more widely separated load areas, where pooling is not so profitable because of transmission costs and losses, advantages, aside from those of emergency protection and surplus exchange, are less certain. It is because of this fact that in most cases interconnections must be preceded by a definite assurance of an economic use and benefit therefrom.

INTERCONNECTION of electric utilities should be differentiated from financial consolidation of companies or interests involved. The fact that these two developments have been taking place simultaneously has lead in some instances to the impression that there is a cause and effect relation between existence of interconnection facilities for energy interchange and concurrent merging of companies or creation of a close financial relationship.[25] Although it is probably true that possibility of interconnection between two utilities with its accompanying economies acts as an inducement to acquisition of one by the other, it must be recognized that the merging tendency among electric utilities is not dependent upon, nor principally due to, interconnections.

[24] See O. N. Hollis, "Interconnection Rates and Contracts," p. 4, paragraph 8.

[25] For example, "interconnection was, indeed, the outstanding feature in light and power news (in 1926). It made possible the taking over by central companies of scores of little private and municipal companies that the 'high lines' had caused to become an economic absurdity." *Electrical World*, January 1, 1927, p. 25.

INTEGRATION in ownership of electric public utilities has been proceeding gradually during the past twenty years and has become especially noticeable since 1920.[26] This development has consisted chiefly in acquisition of operating utilities in widely separated localities through stock control by holding or management corporations. The purposes of these systems have been alleged to be those of securing:

(1) more efficient management of local properties;

(2) economies of more highly skilled and experienced engineering supervision, and

(3) savings in financing done on a larger scale and at more favorable periods.

In all of these services the holding concern is assumed to excel local operating companies. The fact that holding corporations acquire operating utilities in different localities for the purpose of diversifying income producing properties indicates that combination by means of them is not ordinarily developed strictly among physically contiguous utility companies which are susceptible of interconnection.[27]

[26] The *Electrical World* reported in 1913 figures showing the distribution of individual electric generating plants among three classes of control, syndicate, independent, and municipal. The data, for communities of 1,000 population or more, was as follows: under holding control, 29 per cent; independently owned, 48 per cent; municipally owned, 23 per cent; *Electrical World*, Sept. 6, 1913, pp. 482–3. Although exactly comparable figures for a recent date are, according to the same authority, not now available, other data exist which indicate the trend toward holding control which has taken place since 1913. Twelve utility interests controlled at the beginning of 1926, 65.6 per cent of the total generating capacity in the United States. These holding organizations, as reported in the *Savings Bank Journal*, October 1926, pp. 46–50, controlled the following percentages of central station capacity; Insull properties, 11.2 per cent; New England Power Company, 10.7 per cent; Electric Bond and Share Company, 9 per cent; North American Company, 7.1 per cent; Byllesby Interests, 5 per cent; Southeastern Power & Light, 4.4 per cent; Edison United Companies (New York city), 3.7 per cent; Pacific Gas & Electric Company, 3.3 per cent; American Water Works & Electric, 3.7 per cent; Southern California Edison Company, 3.3 per cent; Cities Service Company, 2.1 per cent; Stone and Webster, 2.1 per cent; total 65.6 per cent. For similar data see, "The Concentration of Control in Power," H. S. Haushenbush, *Annals*, Jan., 1927, pp. 118–125. "During the year 1925, the merging of electric light and power utilities affected 560 companies, of which 153 were absorbing companies and 407 acquired. The capitalization of the 407 acquired companies totalled approximately $1,957,000,000, or about one-quarter of the aggregate capitalization of the electric light and power industry." *Electrical World*, January 2, 1926. "The most marked characteristic of our modern economic life has been the passing of the electric industry into the hands of a few large holding companies and the connection of the different plants by transmission lines. Virtually in every case this means increasing the capitalization resting on the industry. From 80 to 90 per cent of the industry is now in the hands of holding companies. More recently these holding companies have been growing closer together. They are now moving rapidly towards community of interest and common ownership and are connecting the lines of one group with those of another and exchanging surplus current among themselves. . . . This is superpower as talked by the present owners of the industry." J. H. Gray, "Giant Power," *National Municipal Review*, March 1926, p. 166. In the use of the term integration in ownership is meant consolidation by holding corporations of operating utility companies and creation of one holding organization upon another so that a pyramiding of corporate structures results.

[27] Although this geographical scattering of operating units in holding corporation systems is practiced, there is, nevertheless, a grouping of them into regional systems, each of which serves many adjacent communities. (See Federal Trade Commission: *"Control of Electric Power Companies,"* February 1927, p. 77). This fact does give some basis for a theory that identity of financial interest running throughout operating subsidiaries of a holding system facilities making of power exchange contracts and rates. This theory is illustrated by specific examples in the following chapter.

INTEGRATION and interconnection in the electric power business present two regulatory problems of importance. First, in so far as intrastate physical connections are involved, state regulation must be depended upon for assuring a development which will be in the public interest. The giant power proposal that an integrated electrical industry should be segregated into separate ownerships in power generation, transmission, and distribution constituted, is an attempt to solve the problem by integration as a physical growth based upon interconnection.[28]

The second problem of power integration and interconnection is that of its interstate or Federal significance. This has both physical and financial issues. Interconnection has gradually resulted in larger quantities of electrical energy going into interstate commerce. The status of these exchanges in respect to regulation of contracts and rates has been determined in a recent decision of the United States Supreme Court. Upholding a series of earlier opinions upon interstate transmission of gas, the court held contracts and rates upon interstate movements of electricity to be subjects of interstate commerce and, therefore, not within regulatory jurisdiction of the states.[29]

THIS decision may affect extension of interconnections for interstate transmission. Electric utilities are opposed to extension of Federal regulatory authority to their industry. This attitude is taken for several alleged reasons. One is the lack of understanding of local utility problems which a distant Federal agency may possess compared with state control.

A second objection to Federal jurisdiction is found in the relatively small amount of electricity entering into interstate commerce.[30] In one case, an interconnection agreement has been drawn with special provision for termination if Federal regulation of interstate electric serv-

[28] "Giant Power Report," pp. 41, 43.

[29] Public Utilities Commission *v.* Attleboro Steam & Electric Co. 273 U. S. 83, P.U.R.1927B, 348, 47 Sup. Ct. Rep. 294. The decision holds transmission of electric energy between two utilities across state boundaries to be purely interstate commerce if or when no element of local distribution enters; that is, when the transmission as an integral movement ends at the station of a receiving company, and does not partake of the further local distributing process which is a separate act of the receiving company. In this distinction there was applied the rule adopted in Pennsylvania Gas Co. *v.* Public Service Commission, 252 U. S. 23, P.U.R. 1920E, 18, 40 Sup. Ct. Rep. 279, involving interstate transmission of gas where local distribution was not part of the essentially interstate movement; conversely, the rule applied in Public Utilities Commission *v.* Landon, 249 U. S. 236, P.U.R.1916C, 834, 39 Sup. Ct. Rep. 268, was rejected. In the latter case, interstate movement of gas in pipe lines was held to be an essential part of the further act of local distribution which was performed by the same company, therefore, having a local interest which permitted state regulation in absence of congressional action. The decision in the Rhode Island case which concerned payment of a contract rate upon an interstate sale of power reads in part (J. Sanford writing): "The test of the validity of a state regulation is not the character of the general business of the company, but whether the particular business which is regulated is essentially local or National in character; and if the regulation places a direct burden upon its interstate business, it is none the less beyond the power of the state because this may be the smaller part of its general business."

[30] It is estimated that not more than 2 to 3 per cent of the total electricity generated now enters into interstate transmission and that, because of limitations upon long distance transmission, it is improbable that electric interchange systems will acquire an important interstate significance. Carl D. Jackson, counselor, N. E. L. A., *Electrical World*, January 15, 1927, p. 146.

ice is authorized by act of Congress.[31] Although in this instance no specific reason is given for desiring to avoid Federal control, the explanation apparently lies in the uncertainty as to ultimate extent of that authority when once initiated.

SUGGESTIONS of substitutes for Federal regulation have been made by interests within the electric industry. Creation of compacts among states interested in any regulatory problem has been proposed. Being dependent upon action by Congress in exercise of its constitutional power to authorize such compacts, the practicability of this suggestion is limited by uncertainty of congressional action.

A second proposal has been that State Public Service Commissions be authorized to act in the capacity of Federal bodies clothed with Federal authority when considering interstate problems.[32]

This suggestion would, perhaps, in the light of Supreme Court decisions, be a constitutional solution of the problem. Under past interpretations by the Court, state authorities have been allowed to exercise regulatory jurisdiction in those fields of interstate utility activity which have been defined as having a local character, until such time as Congress might declare its intention of assuming control. The proposal contemplates making this practice an affirmative legislative policy of Congress subject to change by Congress at its will. It is considered that such legislation would not be held unconstitutional for the reasons that:

(1) The policy is but an extension of present Court interpretation and;

(2) Congress would not be dividing its purely interstate jurisdiction with the states but merely allowing them a temporary power over interstate matters of local significance subject to congressional decision to revoke this control.[33]

The conclusion may be stated that successful practice of either of these two proposals in substitution for what is anticipated as active regulation by Federal agencies of electrical utilities is perhaps more dependent upon the policy adopted in Congress than upon their constitutionality or practicability.

THE interstate problem of electric utility interconnection is equally important in the possible effect of Federal regulation of interstate electric transmission upon holding corporations having interstate interests. As stated above, a causal relation between interconnection and financial integration into large interstate electric systems is not direct. Rather is it the significance which Federal regulation of such transmission might have for interstate holding organiza-

[31] "Interchange Energy Contract; Chicago Area," Article X, § 7.

[32] For the two suggestions see: "The Narragansett-Attleboro Decision," Carl D. Jackson, *Electrical World*, January 15, 1927, p. 146; *Re* Susquehanna Power Co. P.U.R. 1926B, 732; Gray, J. H., *National Municipal Review*, March 1926, p. 170.

[33] This doctrine appeared in the Rhode Island decision cited above and in the following decisions: West *v.* Kansas Nat. Gas Co. 221 U. S. 229, 31 Sup. Ct. Rep. 564 (1911); Simpson *v.* Shepard (Minnesota Rate Cases) 230 U. S. 352, 33 Sup. Ct. Rep. 729; Western U. Teleg. Co. *v.* Foster, 247 U. S. 105, P.U.R.1918D, 865, 38 Sup. Ct. Rep. 438; State ex rel. Barrett *v.* Kansas Nat. Gas Co. 265 U. S. 298, P.U.R.1924E, 78, 44 Sup. Ct. Rep. 544.

tions that makes Federal control undesirable from the private point of view. If Federal regulation of an operating electric utility in its physical interstate character is initiated, extension of that regulatory authority to financing and management companies which control the operating units is rendered a more logical step. Such holding corporations are not now subject to regulation by State Public Utility Commissions. Their functions of holding securities and of drawing income from operating utilities in several states might justify extension of Federal regulation to them if it could be initiated in a field so obviously interstate in character as are interchanges of energy across state boundaries.[34]

[34] The contention has been made that authority already rests in the Federal Trade Commission to compel interstate financing companies in the electric utility field to file reports of their business with the trade commission. See W. Z. Ripley; "Stop—Look—Listen," *Atlantic Monthly*, Sept. 1926, pp. 397–399.

THE foregoing discussion has dealt with what are deemed principles of primary importance in evaluating the significance of electrical interconnection. The principles of diminishing costs and of diversity economy have been offered as justifying interconnection of generating capacities of electric utilities. Pooling of generating capacities in order to secure maximum operating economy has been defined as the most perfected form of interconnection. Conclusions are presented respecting the economic practicability of utilizing water power stations and mine-mouth plants. Finally, some relations between interconnection and integration in the electric industry have been stated especially with regard to regulatory problems concerned.

"THE state did not impose upon the owners the burden of making this investment," said the Ohio Commission in fixing rates of a natural gas company. "As a matter of fact, the capital here employed first appeared in the guise of a suppliant for the right to occupy the public ways with its apparatus. If it now develops that the promotion was ill advised, the owner cannot, in justice, ask the people to contribute an unreasonable wage to render the operation profitable. . . . The history of this enterprise demonstrates that the owners are not in step with modern methods. Instead of the always unsuccessful program of increasing rates to meet diminished consumption the management must turn to the American policy of lessening rates through increased consumption, economical operation, prudent investment, fair bargaining, etc." Re West Ohio Gas Co. (Ohio) P.U.R.1928C, 385.

As Seen from the Side-lines

"WHEN were you born?" he said. "1885," I replied.

* *

HE lounged back comfortably in his chair, looked reflectively above and beyond me, and observed, "Yes, that was just about the time; the time I organized my first public-utility corporation."

* *

HE then was but twenty-eight years old. He was unwealthy, possessed but an academy education, and lived in a sparsely-settled section of Maine, up towards Bangor, where the natives "came down to get drunk and Lord how they dreaded it," a section which because of its remoteness afforded little or no prospect of corporate wealth. But he was a dreamer; and he was hell-bent for organization.

* *

YOU have probably guessed that this "he" is Arthur Robinson Gould, now United States Senator from Maine. Anyway, it is. And all his life he has been an organizer. Give him an idea, and he would straight-away run to a lawyer and organize it. He has produced as many corporations as any other individual in Maine, and every one of them has been successful. From the day when as a boy of twenty-eight, he organized the lumber interests of his remote neck of the woods, Arthur Robinson Gould has stood out as a living refutation of the thoroughly biased suggestion that the Yankees of Maine were born with plenty of hard sense but utterly without imagination.

* *

GOULD organized and built the New Brunswick Electric Power Company, Limited.

* *

HE organized the Aroostook Lumber Company.

HE organized and built the electric railroad from Presque Isle to Caribou, linking it with the Canadian Pacific.

* *

HE organized and built the Aroostook Railroad Company.

* *

HE organized and built the Presque Isle Electric Company.

* *

HE organized and built the Gould Electric Company, and absorbed into it some of the most valuable water-power sites in all that broad expanse called Maine.

* *

AND then he came to the Senate. He came to fill the unexpired term of Bert Fernald, who died in the bloom of his career. And now he is going to quit—to quit not through political pressure or opposition, but of his own volition. He came here and found a farm-relief bloc, a tariff bloc, an anti-power bloc, a migratory-bird bloc, a Young Guard bloc, a Hoover bloc, an Old Guard bloc, a Democratic-Progressive bloc. Everywhere he turned he found congealed, unelastic blocs. No chance for him to organize anything there.

* *

AND he quit.

* *

IT could well be assumed that a man, now in his seventy-third year, who was able to hammer a fortune out of the cold prospect of a remote Maine hamlet, has acquired a philosophy of his own as he has walked down the highway of life's experience. It is, as you would expect, a simple, homely, *naive*, typically Maine philosophy. And Gould's philosophy is merely this:

* *

"FOLKS are folks. Being so, let us all go through life showing some of the

milk of human kindness for each other."

* *

YOUR care-free observer, flitting from flower to flower, would say that he is intellectually dull and that his five years of service in the United States Senate will be entirely forgotten because he failed to make a dent; that he did not ring the bell. It is true that Gould has not been the town crier of Washington. But I have seen him as a man of extremely sound horse-sense and with a happy outlook on life that has enabled him to bear his seventy-three years without the physical ravages that mark the ordinary business-man.

* *

TAKE his view upon prohibition, as an example.

* *

He remarked of it, to my good friend, "Bob" Norton of the Boston *Post*. "When I go up home to see my oldest brother, (he's now 82), he has a bottle of good liquor on the kitchen shelf. He gets it down, and we take a drink. It mellows him and it mellows me. Then we sit down and talk of father and mother and the boys and the things we have done and known together all our lives. Now, I don't see any reason why brother and I should be put into jail for that. Yet we could be.

* *

ONE might disagree with his outlook upon the subject of prohibition, but hardly with the venerable amiability therein contained.

* *

SOMEONE suggested he was quitting because the Anti-Saloon League, long a pillar of righteousness and a spring of political purity in the orthodoxically prohibition state of Maine, had determined to beat him because of his outspoken hostility to the amendment.

* *

"NOT a damned thing to it," he said, and that was that. Being unaffected, he is straight and direct. He thinks that prohibition makes for graft and corruption, not for temperance and good order. On that he stands. Possibly his critic would insinuate that that does not demonstrate a high intellectual estate. But, doesn't it? Possibly Gould has been turning the subject over in his mind for fifty years and merely announced his final and conclusive judgment without caring to "waste the time" of stating the intellectual reactions which produced his decision. Calvin Coolidge showed his first important speech on peace and disarmanent to a friend before its delivery.

* *

"Splendid, Mr. President," exclaimed the friend. And, a minute later, "Mr. President, how long were you writing that speech?" "All my life," replied the President.

* *

MR. Gould continues, and from this, you will be enabled to draw some more of his philosophy:—

* *

"I WAS never much for politics; was too busy doing other things. I don't know anything about politics today, but my opinion is that it is a game which makes it pretty hard for a man to be honest with himself. The biggest and cleanest man I ever knew in politics was Calvin Coolidge. They couldn't fool him. You can bet your life he always kept his head, and you can bet your life that the American people knew this."

* *

ON the afternoon of the day when his term expires he will board a northbound train for Maine, where he will arrive the following morning. He is anxious to be back again in the pine woods and close to the public utilities which his imagination inspired; to be back again among the old friends of a lifetime.

* *

AND we hope, for the sake of venerable amiability, that the older brother has kept a little in the bottle for that morning.

John T. Lambert

What Others Think

A Plea for Uniform International Air Regulation

A GREATER uniformity of international regulation of aircraft is imperative for the smooth development of commercial aeronautics which seem pending in the transatlantic and transpacific fields, according to an excellent article on "International Air Navigation Conventions" appearing in Volume 2, No. 5 of the *Southern California Law Review,* by Professor Fred D. Fagg, Jr., of the University of Southern California. Professor Fagg, through very painstaking research, reviews all of the more important international conventions and treaties bearing on this subject and attempts to analyze difficulties still standing in the way of perfect accord among the family of nations, in the matter of aircraft regulation.

First he points out that the trouble with the original Commission International de Navigation Aérienne, better known as the CINA Convention, was an article providing that no contracting state should,

> "except by special and temporary authorization, permit the flight above its territory of an aircraft which does not possess the nationality of a contracting state."

The purpose of this was to bring pressure on noncontracting states to become signatories. The effect, however, appears to have been just the contrary. This provision was later modified so as to permit the flight over a contracting state by aircraft of noncontracting nations where a separate agreement existed between such parties, but that the present situation is still unsatisfactory and that there is need for another principal international convention is evidenced, according to the author, by the large number of these bilateral agreements still in existence.

CONCERNING the question of sovereignty, Professor Fagg questions the soundness of the sovereignty theory as opposed to the freedom of the air to the individual. He says that this is a result of the war but that it may have the effect of hampering the peaceful activity of commercial aircraft. He claims that the desirable situation would seem to be one which allowed police protection to the state in the time of war without unduly burdening commercial growth over the long peace period merely because of the possibility of future hostility. No plan which fails to harmonize these two interests offers a solution to the difficulty.

Again, he questions the propriety of testing the nationality of aircraft by its ownership and sets forth some objections to this theory, as well as some instances where other *criteria* have been used. The author then reviews the many differences in the treatment by the various conventions of the principles governing the establishment and conduct of international air navigation services. He concludes:

> "In pointing out the important distinctions and possible changes, the foregoing summary statement has indicated also the present undesirable situation. Too many of the treaties are loosely phrased and incomplete in their provisions. Yet the régime of bilateral agreements must continue until the CINA Convention, or some other, can include all European States, at least. If in the interests of uniformity and the furtherance of international commercial aviation, some revision is necessary to meet the new problems that are arising, the first step is to assemble the facts. This

discussion aims only to assist in that process."

THE INTERNATIONAL AIR NAVIGATION CONVENTIONS AND THE COMMERCIAL AIR NAVIGATION TREATIES. By Fred D. Fagg, Jr. *Southern California Law Review*, Volume II, No. 5. June, 1929.

The Growth of American Power Plants Compared with Foreign Growth

THE growth of the electric light and power industry has been one of the most remarkable developments of the last century, according to the 1929 Commerce Yearbook.

Since 1902, the aggregate capacity of generators in electric stations has multiplied 13 or 14 times while the actual output of these stations has multiplied 18 or 19 times as against an increase of only about 51 per cent in the population.

The United States has about half of the total world capacity of public utility electric plants. Norway, Canada, and Switzerland are the only countries in which the output of current per capita exceeds that in the United States. Moreover, much of the Swiss current is exported or used by heavy traction electrifications, while in the other two countries the paper making and electrochemical industries consume a large proportion of the total. The United States is ahead of any other country in the general household use of electricity, and far ahead of most. Although Japan has the next largest number of domestic consumers, the amount of current used by each consumer is far smaller than in the United States.

The operations of the electric light and power industry are summarized in the following statement:

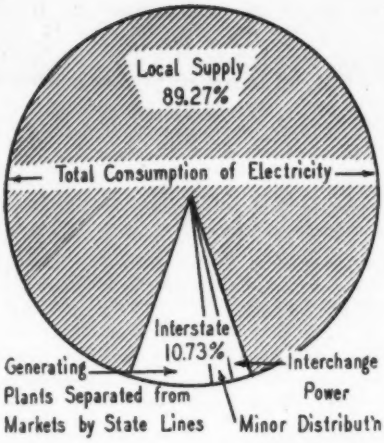
During 1928, the public utility electric plants, including electric railways, produced nearly 88,000,000,000 kilowatt hours of energy, about five times the output of 1912, two and one-fourth times that of 1919, and 9.5 per cent more than in 1927. During the last few years current generated by water power has increased much more rapidly than that derived from fuel power; the percentages of increase in 1928 over 1927 were 16.1 and 5.6 respectively. Steady improvement in the efficiency of central-station operation is shown by the reduction of the number of pounds of coal or its equivalent burned per kilowatt hour from 3.2 in 1919, to 1.84 in 1927, and 1.76 in 1928. The factory equipment of the country is being rapidly electrified and it is estimated that in 1927 about 70 per cent of the power used in factories was applied by means of electricity as compared with about 33 per cent in 1914.

Practically all the increase in factory power equipment since 1914 has been in electric motors operated by current from central stations.

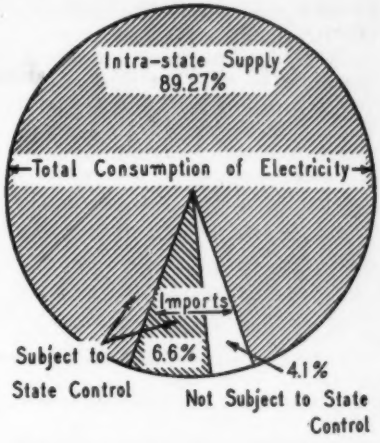
COMMERCE YEARBOOK; Volume I, Washington, D. C.: United States Department of Commerce. 720 pages. $1.00. 1929.

When Electricity Crosses the State Line

Is interstate electrical commerce the loophole in present day utility regulation? The critics of Commission regulation, the advocates of Federal regulation of electric utilities engaged in interstate commerce, the advocates of government ownership—in short, all who feel that the present plan of controlling this most important branch of public service is not all that it should be—have repeatedly asked this question. Recently, with the constant improvements of long distance transmission methods, the question is heard



The extent of interstate transmission of electricity in 1928



The extent of state control over the supply of electricity in 1928

more than ever; the question is becoming important.

No answer can be made intelligently unless the portion of the total amount of electricity used in utility service in the United States passes across state lines in interstate commerce is determined. Having gone this far, it is then necessary to determine just what portion of such interstate electrical commerce is *not* subject to regulation.

The accurate ascertainment of these facts is a large order but the National Electric Light Association appears to have made a thorough job of it in its *Statistical Bulletin No. 4.* There is more real information and statistical research crammed into these eight pages than in many similar surveys of five times its size. The reported amount of interstate power transferred in utility service was 8.99 per cent of the total United States consumption of 1926. In 1928, it was 10.73 per cent, showing an increase probably due to the improvement of long distance transmission facilities. The following illustration summarizes the findings.

The regulatory features of interstate power thus transferred is revealed in another illustration.

In other words, while it is nothing more or less than a routine survey, this bulletin differs from all other surveys in that it goes a long ways towards clarifying the old argument about the interstate loophole.

—F. X. W.

INTERSTATE TRANSFER OF ELECTRIC POWER IN 1928. New York: National Electric Light Association. *Statistical Bulletin No. 4.* 8 pages. 1929.

The Steady Onward March of the Motor Vehicle

VERY brief but very significant is the report on motor transportation in the *1929 Commerce Yearbook.*

It appears that there were in the United States in 1928 approximately 21,379,000 passenger automobiles and busses and 3,114,000 motor trucks, making a grand total of 24,493,000 cars, besides 137,000 tax-exempt official cars and 122,000 motor cycles. The

number of automotive vehicles increased about 6 per cent as compared with 1927. The annual additions during each of the last five years have varied from about 1,100,000 to 1,500,000. There were in 1928 about 204 motor vehicles for each thousand of the population.

It is stated that the commercial use of motor vehicles is steadily expanding. Motor busses are serving many towns and communities which would otherwise be out of immediate touch with any rapid transportation service. The use of the motor truck for hauls on country roads as well as in city streets is being steadily expanded. Trucks and busses are being employed on a large scale by a number of railway companies as auxiliaries to their services.

There are, however, no adequate statistics of commercial transportation by automotive vehicles.

COMMERCE YEARBOOK, Volume I. Washington, D. C.: Issued by the United States Department of Commerce. 720 pages. $1.00. 1929.

The Intrusion of Politics Into Traction Problems

"WHEN things are moving along normally," said Samuel Insull recently in an address before the Chicago Association of Commerce, "a very large number of those who will admit they are our best citizens (as well as some who ought to know better) put in their spare time damning the utilities for sins of omission, commission, and imagination. *But* when help is needed to render a service or to carry a load the first call that goes out is to the utilities. They are even called the mainstay of the country, in troublous times."

The size of the traction job in Chicago was thus outlined:

> "At this time, nothing that anyone can think of would do more to stimulate business—everybody's business—than to give traction the solid, substantial, financial structure that will permit it to undertake the job of catching up with the city's needs. For the transportation service to overtake the city's requirements, $300,000,000 will be necessary. Everyone is agreed that this is the minimum gross amount which will have to be spent within ten years—$200,000,000 for extensions and betterments and $100,000,000 for subways. This means spending at the rate of $30,000,000 a year—at a greater rate than that for the first few years—for labor, equipment, and materials. Also it will be new money put to work; new money to be respent by those to whom traction will pay it out, for the benefit of every branch of trade and commerce.
>
> "Nor will the expenditure of new money end with the ten years proposed for the reconstruction work now in sight. With a sound financial structure, traction will expand, extend, and better its service year by year as long as Chicago grows and prospers, as the other utilities do now."

AN incidental but important result of traction development was then mentioned by Mr. Insull:

> "Nor is the expenditure of thirty or more millions of new money a year the only benefit that will come from putting traction on a solid financial foundation. Improve the facilities, and property values will be increased and business stimulated throughout the area of the existing transportation system. And wherever a new line is run, wherever an extension reaches, there will be so tremendous an increase in business and in values that the people of such neighborhoods will themselves be amazed. This is the history of every extension, every addition made to the transportation system. Vacant lots are transformed into paying business and residence properties with a speed that we can hardly believe to be possible. Land values multiply for the simple reason that rents are coming in, instead of only taxes going out."

The development of local transportation facilities not only puts thousands of dollars into the pockets of the public in the way of increased real estate values, but it makes retail stores more available to customers, and manufacturing plants more accessible to employees. It helps raise the standard of

living conditions of the people. The traction companies, however, are not only subjected to substantial competition, but are also laboring under the handicaps which Mr. Insull attributes partly at least to politics. He said:

"But traction is in politics, and because traction is in politics, one would have to be gifted with second sight before he would even try to guess what that fundamentally important branch of the utility service will, or can, do, in the way of new expenditures to help stabilize the prosperity of the city and for the improvement and extension of its service."

". . . in repeating that the chief trouble with traction is politics, I am not criticising either the politicians, the lawyers, the newspapers, or the public. I am simply stating what I believe to be facts. We all know traction has been in politics from one generation of politicians, lawyers, and public to another. Traction was in politics twenty years ago, and thirty years ago, and before that. One generation inherits it from another. Politicians, lawyers, and newspapers are all influenced by circumstances. If a question—any question—is made a political issue, they take sides. What I am getting at is that the question of a sound financial set-up for traction, or any utility, is one of economics and not one of politics at all."

Mr. Insull emphasized the fact that the money needed for traction development in Chicago cannot be spent until it is raised, and that there is no chance to raise it except upon solid security.

TRACTION—THE LAME DUCK. Address of Mr. Samuel Insull. Chicago: Chicago Association of Commerce. December, 1929.

How the Gas Utilities Are Expanding Under the Present System of Regulation

ALTHOUGH gas is being gradually superseded by electricity for lighting, the production has nevertheless steadily increased because of the greater use of gas for cooking, heating, and industrial purposes. According to statistics collected by the American Gas Association, there has been a steady in-

Net Prices of Manufactured Gas for Household Use in Specified Cities

Note:—Prices based on a family consumption of 3,000 cubic feet per month.

(Per 1,000 cubic feet)

DATE	PRICE	DATE	PRICE	DATE	PRICE
Average, All Cities Specified		*Average, All Cities Specified —Cont'd.*		*Average, All Cities Specified —Cont'd.*	
April 15, 1913	$0.95	April 15, 1920	$1.09	Dec. 15, 1925	$1.23
April 15, 1914	.94	May 15, 1921	1.32	June 15, 1926	1.23
April 15, 1915	.93	March 15, 1922	1.29	Dec. 15, 1926	1.22
April 15, 1916	.92	March 15, 1923	1.25	June 15, 1927	1.22
April 15, 1917	.91	June 15, 1924	1.24	Dec. 15, 1927	1.22
April 15, 1918	.95	Dec. 15, 1924	1.24	June 15, 1928	1.21
April 15, 1919	1.04	June 15, 1925	1.23	Dec. 15, 1928	1.22

Prices as of December 15, 1928

CITY	PRICE	CITY	PRICE	CITY	PRICE
Atlanta	$1.55	Manchester	$1.34	Portland, Ore.	$1.17
Baltimore	.85	Memphis	1.20	Providence	1.13
Birmingham	.80	Milwaukee	.82	Richmond	1.29
Boston	1.18	Minneapolis	.90	Rochester	1.00
Bridgeport	1.45	Mobile	1.76	St. Louis	1.00
Butte	2.10	Newark	1.20	St. Paul	.90
Charleston	1.55	New Haven	1.13	Salt Lake City	1.51
Chicago	.98	New York	1.25	San Francisco	.94
Cleveland	1.25	Norfolk	1.33	Savannah	1.45
Detroit	.79	Omaha	1.00	Scranton	1.40
Fall River	1.15	Peoria	1.20	Seattle	1.45
Indianapolis	.95	Philadelphia	1.00	Springfield, Ill.	1.25
Jacksonville	1.92	Portland, Me.	1.42	Washington, D. C.	1.00

crease in the quantity of gas sold each year since 1905. The quantity sold in 1928, 490,000,000,000 cubic feet was about 53 per cent greater than in 1920 and 4 per cent greater than in 1927.

Prices for manufactured gas are stated to be more or less independent of conditions of supply and demand, being usually fixed by the terms of franchise agreements or by regulations of the public authorities.

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One Way in Which the Massachusetts Commission Sought to Avoid Compliance with the Supreme Court Doctrine

"FOLLOWING *the appeal of the Worcester Electric Light Company to the Federal Courts, the Commission submitted, in December 1927, another special report to the legislature in which it emphasized the dangers it anticipated from any attempt to enforce its compliance with the Supreme Court doctrine. It also submitted, with its recommendation and the support of the governor, a bill designed to exempt the Massachusetts Commission from applying the present fair value doctrine. In essence the proposed bill provided for the establishment of contractual relations between the state and the gas and electric companies. Those companies which should enter into such a contract were to be permitted, on application to the Department, to readjust their capital structure. . . .*

"To force the reluctant companies to enter into this contractual relation, the proposed bill provided that such companies as did not accept should not be given the power to take property by eminent domain, nor should they be permitted to issue any additional stock or bonds, and that the present statutory provisions which require any municipality about to engage in the gas or electric business to purchase any local property of the existing gas or electric company, if the latter chose to sell, should not apply.

"The legislation was bitterly opposed by the gas and electric companies of the state."

The March of Events

Alabama

Rate Reductions Stressed in Annual Report

THE year of 1929 was marked by the most substantial reductions in the rates of public utilities ever established by any previous Commission in the state of Alabama, according to a statement in the annual report of the Public Service Commission which has recently been filed. The assertion is made that power and lighting rates in Alabama are lower than in any state in the South and compare favorably with any in the United States. Substantial reductions have also been made in gas rates, notably those for house-heating service.

Progress has been rapid in the revision of freight rate structures. Several important commodities have been treated by the Commission, including materials for road surfacing and cotton. The Commission also handled approximately 500 petitions from the carriers voluntarily proposing changes in rates, rules, or regulations. A large part of these, it is said, resulted in reductions. Furthermore, the Commission represented the shippers of Alabama in a number of cases before the Interstate Commerce Commission.

The problem of adequately regulating motor bus and truck operators has presented many difficult cases to the Commission. More than 190 formal cases were heard during the year. The informal orders amounted to 283, while minor complaints not covered by either formal or informal orders but adjusted by the Commission amounted to 491.

It is said to be the opinion of the Commission that adequate regulation of motor carrier service cannot be enjoyed by the public until Congress has delegated authority to some board for its interstate regulation. Until this is done, it is pointed out, Alabama citizens who have invested large sums of money in the business are without protection against their interstate competitors; and the public, while temporarily, perhaps, enjoying this competitive service, will not, in the long run, be benefited by this territorial warfare between transcontinental bus operators.

The Commission discusses the introduction of natural gas from the Louisiana fields and explains its reasons for restricting the use of this product in the Birmingham district.

"The unregulated sale of natural gas in the Birmingham district would have played havoc with millions of dollars of Alabama and, moreover, it would have meant the loss of employment to hundreds of coal miners," it is stated.

California

Natural Gas Boom

AT the present time 80 per cent of all the gas consumed in the state is natural gas, according to a report by Claude C. Brown, gas administrator of the Railroad Commission. He states that there are under construction a number of projects which will undoubtedly be completed within the next twelve months. Upon the completion of these additional projects the area served with straight natural gas will be greatly enlarged and some 98 per cent of all the gas consumed will be natural gas. His statement continues:

"Up to August of this year [1929], all gas used north of Bakersfield was manufactured oil gas of 550 B.T.U. quality. However, at 5:30 P. M. on August 16, 1929, the first straight natural gas was delivered into the San Francisco Bay area from the recently completed pipe line which has been constructed by the Pacific Gas & Electric Company from Kettleman Hills to the bay area.

"Since that date straight natural gas service of 1175 B.T.U. quality has been instituted along the line from San Jose to the San Francisco county line on the west side of the bay and from San Jose as far north as Hayward on the east side of the bay.

"San Francisco and the East Bay area are now being served with reformed gas of about 585 B.T.U. quality, which service will be changed to straight natural gas upon the completion of a second line from Kettleman to

be completed some time in April or May of 1930.

"As soon as possible after the completion of the second line the service of straight natural gas will also be instituted in the area along the route of the second line (west side of the San Joaquin Valley) and the cities and towns around and near Modesto, Oakdale, Stockton, Lodi, Sacramento, Roseville, Woodland, Davis, Antioch to Richmond, Vallejo, Napa, and Marin, and Sonoma counties as far north as Santa Rosa."

Must Telephone Company Reveal Bootleggers' Numbers?

THE question whether a telephone company must disclose to Federal enforcement officials the secret numbers of "telephone bootleggers" has been raised in San Francisco. The trouble started when the Pacific Telephone & Telegraph Company, on December 21st, refused to furnish such numbers demanded in two subpoenas issued by the Federal authorities.

Officials of the company have insisted that they should first be convinced that the subpoenas are legal. One of the points upon which a decision may hinge is whether the information is demanded in order to run down suspected bootleggers or whether the information is sought as corroborative evidence to be used in hearings of suspects already under arrest. The company has demanded that it be shown the complaints in connection with which the phone locations are sought.

Conferences during the latter part of December between representatives of the company, Federal Commissioners, and other Federal officers apparently failed to find a solution. It was predicted that the three Federal district judges in that area would be called upon to decide the matter.

Colorado

Commission Report Reveals Extensive Track Abandonment

MORE than 850 miles of railway track has been abandoned or taken up within the state since 1916, while the Interstate Commerce Commission's examiner has recommended the abandonment of 185 additional miles, and another line of about 125 miles has not been operated since last May on account of a mountain slide and the subsequent receivership of the company, we are informed in the annual report of the Commission recently made public and published in the newspapers.

"The report," says the United States Daily, "also states that there were 356 motor vehicle carriers operating under certificates from the Commission and 11 operating without certificates, or a total of 367 carriers reporting to the Commission as of November 30, 1929. This compares with a total of 247 carriers reporting as of November 30, 1928.

"The report gives statistics compiled from annual reports of motor vehicle carriers for the year ended December 31, 1928, as follows: Cost of motor equipment, $2,092,681; gross revenue, $2,654,546; total expenses, $2,425,519. Passengers carried, 1,448,622; tons of freight hauled, 75,996. Passenger vehicles owned, 709; freight vehicles owned, 196.

"These figures do not include data pertaining to interstate or sight-seeing carriers, the report says.

"The Commission received reports from 37 private and 20 municipal electric utilities, 7 private and 1 municipal gas utilities, 24 private and 88 municipal water utilities, 61 private telephone utilities, 23 steam railroads, 8 private street railways, and 10 miscellaneous utilities.

"In addition, the report says, there are approximately 80 other municipal utilities in the state which did not file reports with the Commission. There also are four air lines operating under the jurisdiction of the Commission.

"One activity of the Commission not heretofore reported, it is stated, is the regulation of common carriers by air. Four companies have been granted certificates to operate and others are pending."

Connecticut

Consolidation Involves Five Utilities

ACTION was taken by five utility concerns on January 7th, according to a report in the New Haven *Register*, that would reduce considerably the pyramid of holding companies in the $1,200,000,000 system, placing the Commonwealth & Southern Corporation, formed last spring, directly at the head of the numerous concerns in the system.

"To carry out this measure," the *Register* continues, "directors of the Allied Power & Light Corporation, the Commonwealth Power Corporation, the Penn-Ohio Edison Company, the Southeastern Power & Light Company, and the Commonwealth & Southern Corporation approved a plan of merger and consolidation. This will result, when completed, in the acquisition by the Commonwealth & Southern Corporation of all assets system.

and its assumption of all liabilities of the four other companies.

"Following the merger, the principal stockholders in the reorganized Commonwealth & Southern Corporation will be, in the order of holdings, the American Superpower Corporation, the Electric Bond & Share Company, the United Corporation, and the United Gas Improvement Company. Together the four holders will own approximately 50 per cent of all Commonwealth & Southern stock and warrants to be outstanding.

"Announcement of the action was made by Bernard C. Cobb, chairman, and Thomas W. Martin, president of the Commonwealth & Southern Corporation. The company owns more than 96 per cent of the common stocks of Commonwealth Power, Southeastern Power & Light, and Penn-Ohio Edison, while none of the stock of the Allied Power & Light had hitherto been owned by Commonwealth & Southern."

Indiana

Orders Allowing Phone Rate Increases Attacked in Court

THE order of the Commission allowing an increase in the rates of the LaPorte County Indiana Telephone Company is under attack by objectors, who are seeking an injunction against its enforcement. A stipulation approved by the court has been entered into which provides that the company must keep the revenue received from the increased rates in a special fund and that, if the order is vacated, the increased rates will be refunded.

The company, says the LaPorte *Herald-Argus*, has also agreed to post a bond covering all increased income paid in if it takes an appeal from the decision of the court which will hear the injunction proceedings and a bond covering prospective revenue while the case is pending before the state supreme court.

"We lose them all," was the comment of Chairman John W. McCardle when informed that an appeal from the Commission order was planned, according to a report in the Indianapolis *Times*. This paper goes on to say:

"McCardle's comment was in regard to what happens to Commission orders when they go to the courts.

"He admittedly has been trying to avoid appeals and since becoming Chairman none has been taken by the utilities. In these rate increase cases the public is appealing.

"In the Terre Haute Case, McCardle rewrote an order prepared by Commissioner Calvin McIntosh, who heard the matter and failed to grant increases McCardle thought were merited.

"The LaPorte Case followed similar procedure with Commissioner Frank Singleton conducting the hearing.

"McCardle said the raises were granted to avoid appeals by the companies."

The city of Terre Haute, through its attorneys, on December 27th filed a petition asking the court to vacate, set aside, and enjoin the enforcement of an order granting increased rates to the Citizens Independent Telephone Company of Terre Haute. The city attacked values found by the Commission, including going concern value, and also payments for salaries and for rate litigation.

Kansas

Statewide Probe of Electric Utilities Ordered

An investigation into the rates, rules, regulations, classifications, practices, and schedules of all electric light and power utilities in Kansas was ordered, on December 31st, by the Public Service Commission. The Commission stated that in the past it had granted increases in rates to electric utilities, or had permitted the utilities to maintain rates, based on high fuel and other costs, but that these costs "appear to have been materially reduced."

Twenty-eight electric utilities were named in the order as respondents and were directed to prepare and present to the Commission a detailed inventory of their property and to present statements showing the revenues and expenses of the companies in all their details.

Louisiana

Fight in Prospect on New Rail Rates

New rail rates that would favor Houston and Galveston, effective March 21st, under an order of the Interstate Commerce Commission, are being attacked in Louisiana. Resort to the courts is threatened, according to a report in the New Orleans *State* recently published.

The schedule would make effective a lower rate to Texas ports than to New Orleans from points on the Texas & Pacific Railway which are farther from New Orleans by 25 per cent than from Galveston. The *State* informs us that the Texas & Pacific and Louisiana & Arkansas railways will take the rate fight to court, seeking an injunction to restrain the new rates from going into effect if the Commission's decision stands.

Chairman Francis Williams, of the Louisiana Public Service Commission, according to the *State*, has advised vigorous resistance in court to the Interstate Commerce Commission's order.

"The Supreme Court of the United States," said Mr. Williams, "has not deviated from the rule laid down by it in the earliest cases coming before it in which the question of port equalization was involved. The rule laid down by the Supreme Court is that a railroad has the legal right to maintain a parity as between competing ports, or, in other words, that a railroad serving one port has the legal right to charge the same rate to the port it serves as it charged by a competing railroad serving another, or competing, port."

Massachusetts

Intercompany Relations Questioned in Gas Case

The taking of testimony in the rate proceedings of the Boston Consolidated Gas Company before the Public Utilities Commission was closed on January 8th. A clash between attorneys over the question of subpoenaing officers of subsidiary or related companies arose.

Attorney Wycliffe C. Marshall, of Watertown, who represents a group of consumers, insisted that the Commission should go into minute details as to the relations between the gas company and other utilities. Members of the Commission were of the opinion that their powers were limited by statute and that they could not compel officers of the other companies to appear. Robert H. Holt, general counsel for the Boston Company, expressed the belief that the Commission's ruling was correct and questioned whether it was material to the investigation what it cost the seller to produce coal, coke, or gas.

A substitute schedule of rates, including a 50-cent service charge, was submitted by representatives for the customers, which, it was alleged, would produce an 8 per cent dividend. This schedule calls for an increase of 5 cents per thousand in the rate on gas used in excess of 100,000 feet per month over the company's schedule, but makes reductions in the lower steps.

Legislative Committee Proposed to Probe Phone Rates

A PROPOSAL has been made that the House and Senate appoint a joint committee to investigate existing charges for telephone service in the town of Andover, with a view to determining whether the state should act to secure a reduction. This move is sponsored by Representative Thomas J. Lane and Arthur F. Ganley, we are informed.

The plan is to have the committee investigate rates, with full power to summon the attendance and testimony of witnesses and the production of books and papers. The committee would be required to report to the General Court the results of its investigation and its recommendations by filing the same with the clerk of the House of Representatives on or before December 1st of the current year.

Michigan

Detroit Fares Insufficient

A RECOMMENDATION of John H. Morgan, auditor for the Detroit Street Railways, for an increase in the fare of the street railway system, says the Detroit *Free Press*, has been before the commission and the mayor for the past several months, but the commission has opposed any increase in the cost of car riding.

The question of profit or loss centers about depreciation. It appears that the fares have not been adequate to permit the accumulation of a depreciation fund, although it is said that there is a depreciation fund for motor coaches.

The street railway department's outstanding debt is $40,724,462.65, says the *Free Press*. This figure represents outstanding bonds in the sum of $22,489,000, notes to the city, Henry Ford, street car, and motor coach contractors.

A sinking fund of $10,641,272.18 has been set aside, of which $4,631,000 is against the bonds outstanding. The street railway department owes the Detroit United Railway $9,772,000, which must be paid in 1931, and to meet this payment, we are told, it is necessary to raise $3,937,000 in the next sixteen months, which amount officials of the Detroit Street Railways admit cannot possibly be raised with the present fare.

Minnesota

Five-Cent Pupils' Fare Opposed by Alderman

ALDERMAN F. H. Brown, chairman of the council street railways and busses committee of Minneapolis, according to the Minneapolis *Journal*, has declared that he would oppose any further attempt to obtain a 5-cent street car fare for school children on the grounds that if any reduction is possible it should be made generally.

"The 5-cent fare which Duluth school children have would not be any benefit here," he said, "because it would not be a saving to more than a very few children whose homes are so far from school that they have to ride every day. The occasional rider would not be benefited because the company would require books of 10 tickets to be used within two weeks. Any left over would be wasted.

"In Duluth the council agreed to give up all extension for two years and made several other concessions to obtain the low rate for school children. We certainly will make no concessions in service in order to obtain a doubtful saving for a small number."

An attempt to obtain lower fares for school children was made by Mayor William F. Kunze several months ago. After that the Parents and Teachers Association took the matter up and applied to the Commission for a lower fare but the Commission ruled that it could not act unless a petition came either from the council or the company. The mayor was expected to request the council to petition the Commission for an order lowering the rate.

Missouri

Increase in Laclede Gas Rate Sustained by Judge

THE order of the Commission authorizing an increase in the rates of the Laclede Gas Light Company amounting to approximately $600,000 a year, was affirmed on January 3rd by Judge Westhues of the Cole county circuit court. City Counselor Muench, says the St. Louis *Post-Dispatch*, has announced that he would appeal to the Missouri supreme court. The *Post-Dispatch* informs us:

"About 85 per cent of the company's customers are affected by the increase which became effective last April 6th, raising the minimum rate of 50 cents for the first 500 cubic feet of gas consumed each month to 75 cents for the first 300 cubic feet.

"The order also provided that the former maximum charge for additional consumption be reduced from $1 to 95 cents per thousand cubic feet. Muench asserted that the rate schedule was arranged so as to increase domestic rates and enable the company to offer lower rates to large consumers.

"Muench attacked the valuation of the company's property, the depreciation allowance made by the Commission and maintained that 6 per cent was a fair return instead of 7½ per cent as allowed.

"The valuation of the property, he asserted, was not more than $40,000,000, whereas the Commission placed it at $47,000,000, and the depreciation allowance, which was increased from 1 per cent to 1½ per cent of the cost of physical property subject to depreciation, was excessive.

"The city further attacked the allowance of $5,818,000 for going value, contending the item should not exceed $1,900,000. Other items, including particularly the reproduction cost of the cast iron mains, also were attacked. Because of the improved methods of laying the mains by machinery and the lower price of pipe, that item should be reduced at least $2,974,928, it was said.

"The contention of the company, represented by its attorneys, Bennett Clark and George Willson, was that the valuation should have been $48,800,000, that the rate of return should be 8 per cent, and that the depreciation allowance should be 3.1 per cent."

Laundry Entitled to Factory Water Rates

CIRCUIT Judge Westhues, in reversing an order of the Missouri Public Service Commission, has held that the Overland Laundry Company is entitled to water service from the St. Louis County Water Company at the rate established for manufacturing concerns, so long as it uses the monthly volume of water required to come under the manufacturers' rate.

The case has been remanded to the Commission with instructions to carry out the intent of the decision. The laundry company had applied to the Commission for classification as a manufacturer but the Commission had upheld the utility in refusing this classification.

New Jersey

Franchise Tax Law Declared Invalid

THE Supreme Court of the United States has held invalid a New Jersey law imposing a franchise tax on gross receipts derived by a corporation from interstate business. The court reversed the decision of the court of errors and appeals of New Jersey in the case of the New Jersey Bell Telephone Company against the State Board of Taxes and Assessment.

The state tax on the telephone company invalidated by the court is reported to be about $250,000 for the year 1928. The litigation acted as a stay upon the levying of the 1929 tax, involving more than $300,000.

Riders Buy Tokens while New Fares are Attacked

THE token system has been effected throughout the state with remarkable smoothness according to spokesmen for Public Service Co-ordinated Transport. Officials report that most riders avail themselves of the tokens at 10 for 50 cents in preference to the flat fare of 10 cents cash. They say that the token arrangement has resulted in a definite speeding up of traffic.

Several schemes have been suggested for fighting the token plan. The Hoboken *Observer* tells us that a new corporation has been organized to operate busses with a 5-cent fare to members of the organization. Members would pay dues of $1 a year. The claim is made that as the busses will not be public conveyances but vehicles operated only for the benefit of the members of the league, it will not be necessary to apply to the Commission for permission to operate nor will it be necessary to secure the consent of the cities through which the busses run.

Profiteering on tokens has been reported. The Newark *Call* says that the legal department of the Public Service Co-ordinated Transport is investigating reports that several Paterson stores are selling tokens at 6 cents each.

In some communities moves are being made to retail tokens in department stores in any quantities desired.

The Commission, in its annual report, says in regard to the new fares:

"Many references have been made to this arrangement as an increased rate. It is true that the object in adopting this plan is to bring about some increase in the revenues, but what this increase will amount to is problematical. It is practically impossible to predict the results of this arrangement. No one is able to tell just how many people will purchase tokens or how many will be required to pay at the rate of 10 cents per zone.

"In view of these facts and the utter impossibility of determining the results, the Board allowed the experiment to be made. The company, as has been the practice in the past, will furnish the Board with periodical statements as to the result."

New York

Mayors Urge Changes in Public Service Law

TEN amendments to the Public Service Commission Law which are of far-reaching importance and affect virtually every municipality of the state have been proposed by the New York State Conference of Mayors. The proposals cover a wide variety of subjects:

To require the Commission to establish a division to make appraisals of property of public utilities for rate-making and regulation purposes.

To extend the Commission jurisdiction to holding companies.

To provide by statute that a time limitation can be fixed by municipalities in consenting to operation of motor busses within their boundaries.

To have the Commission increase rates for public utilities only after a hearing on notice to the municipalities affected.

To empower the Commission to impose conditions in permitting abandonment of a franchise.

To compel public utilities to show separately receipts of the utility in each municipality when reporting to the Commission.

To give the Commission jurisdiction over rates of water companies.

To make property values reported by public utilities for tax purposes presumptive evidence of value for rate-making purposes.

Other proposals relate to greater legislative control of aviation and the supervision of private aviation schools.

North Dakota

Room Rate Electric Schedule Filed with Commission

DURING December the North Dakota Power & Light Company filed with the Commission a schedule of reduced electric rates applicable in the 57 towns in which it operates. The new schedule is on a room-rate basis.

The company filed one schedule for its class "A" towns, Bismarck, Mandan and Dickinson, the three largest cities on its system, and one for its class "B" towns, the

balance of the towns served. The schedule for the class "A" towns contained reductions in all of the rates and the Commission approved the schedule, effective with December meter readings.

The "B" schedule also provided for reduced rates, on a slightly higher scale than the "A" schedule, but in addition provided for an increase in the minimum bill from $1 to $2. The Commission approved the "B" schedule in so far as the rates themselves were concerned, but suspended the increased minimum charge pending investigation as to its reasonableness. The Commission, under the utility law, cannot approve increases in rates without a hearing to determine their reasonableness, after proper notice to the public has been given.

Ohio

Columbus Gas Rate Case before Commission

THE Columbus Gas & Fuel Company has protested to the Commission against a 48-cent rate established by ordinance and has asked the Commission to determine and fix a just and reasonable rate. Frank W. Geiger, chairman of the Commission, according to the Columbus *Dispatch*, has intimated that the matter will be heard during the month of February.

The company declares that it has not accepted the 48-cent rate established by the city and complains that a price of 75 cents without discount as a minimum per month per customer and 48 cents for each additional thousand feet of natural gas, with an additional charge of 5 cents for each thousand cubic feet if monthly bills are not paid within the prescribed time, "is and will be unlawful, unjust, unreasonable, and insufficient to yield a reasonable compensation for the service."

The complaint follows the decision of Judge Benson W. Hough in Federal court in which he held that the gas company was not justified in claiming the 65-60-55-cent rate ordinance passed and then repealed by the council last summer to be a valid contract. An appeal to the United States circuit court of appeals was predicted in this case.

Pennsylvania

Franchise Transfer without Consent of City

THE question whether a street railway company may transfer its franchise rights without the approval of the city in which it operates, if it obtains approval from the Public Service Commission, has been raised in injunction proceedings of the East Penn Traction Company against the city of Pottsville. The company has taken the position that while in the first construction of a street railway it is necessary to secure permission of a city council, afterwards vested rights under the franchise can be transferred by consent of the Commission without assent of city council.

Representatives of the city contend that no transfer of corporate rights in the streets can be made without such municipal consent. They rely upon a decision of the supreme court holding that the Public Service Commission Act in no way interferes with the ownership and control of the city streets by council.

Wisconsin

Fare Increase Opposed in Court Proceeding

A SECOND attack on the 10 and 13-cent fare charged to residents of what was formerly North Milwaukee, according to the Milwaukee *Journal*, was launched on January 9th when Judge Daniel W. Sullivan signed an order requiring the street car company to show cause why it should not be permanently restrained from charging more than the regular city fare.

This move followed a complaint by Attorney P. J. Harrington alleging that since North Milwaukee became a part of the city in 1929, the company has charged 10 cents in one zone and 13 cents in another.

The Utilities and the Public

Annual Depreciation Must Be Estimated at Present Value

THE recent decision of the United States Supreme Court in the case of the United Railways & Electric Company of Baltimore against the members of the Maryland Commission, reported in this issue of the PUBLIC UTILITIES FORTNIGHTLY, is probably one of the most important decisions of the law of public utility regulation ever handed down by the Court. It seems destined to be placed in the same category as Smyth *v.* Ames, McCardle *v.* Indianapolis Waterworks Company, the O'Fallon decision, and other leading utility controversies which have come up for review.

To appreciate the full significance of the Baltimore Fare Case, it is necessary to reflect upon the biggest question ever raised by utility regulation,—to wit, present value versus original cost as a basis for calculating the value of utility property for rate-making purposes. As far back as 1898 the Supreme Court in Smyth *v.* Ames decided in favor of present value. Since then there has been a line of decisions including the recent O'Fallon decision in which the Court has consistently reaffirmed this general principle of valuation, and still the question persists because of the difficulty of stretching a single general principle over the many phases and details of utility valuation without numerous supplementary decisions.

The annual allowance for depreciation is one of these special phases that required a separate decision to settle, once and for all, the manner in which the present value principle should be applied to it. Soon after it became established that reproduction cost was to be more or less the criterion of utility regulation proper, some Commissions began to make distinctions between the value of the property and the annual allowance for its depreciation. Estimation of the latter, they held, should be made on the basis of the original cost of the property consumed in public service.

The purpose of this depreciation allowance is to permit the utility to maintain its capital investment devoted to public use at an approximate level. In the course of ordinary operation, utility property naturally deteriorates in a manner not covered by current replacement, so that portions of the value are being consumed in public service for which the utility is entitled to be reimbursed. Those Commissions which held that the depreciation should be estimated on the basis of the original cost of the property so consumed took the position that the company was entitled to be paid back only what the consumed property had actually cost them. There were others, however, who believed that the allowance should give due regard to the reproduction cost of the depreciated property. The former treatment appeared to have

been supported by the weight of authority.

This was the situation when the United Railways asked the Maryland Commission for a rate increase. Applying its customary procedure, the Commission found a depreciation allowance on the original cost of the property. The utility appealed to the court of appeals, which is the highest court in the Free State. That court while sustaining the Commission on other grounds (which will be discussed later) reversed the Commission on the point of depreciation allowance, holding that it should be based on the present value. Giving the opinion of the Maryland court in that proceeding, Judge Offutt stated:

> "Counsel for the Commission suggests that to restore value would be to 'require the financing of additions to plant, to the extent of the excess of replacement over original cost of property replaced, by the public, which would in turn have to pay a return on the capital thus required.' The meaning of that suggestion is not altogether clear, but if it is that the company is entitled to the return of anything less than the value of its property it cannot be sustained. Money deducted from earnings to replace equipment which has become worn out or obsolete, by other equipment of the same character and the same value, adds nothing to the company's resources but merely keeps them at the same level."

When the railway company appealed from the court's decision on the question of the amount of return to be allowed to the United States Supreme Court, the Maryland Commission took a cross-appeal on this point of depreciation. The highest court sustained the decree of the Maryland court on this point, holding that it would be "illogical" to compute annual depreciation on the basis of original cost while otherwise valuing the company's property at its present fair value. Judge Sutherland, rendering the majority opinion, pointed out that the depreciation allowance cannot be limited by the original cost for the reason that if values have advanced the allowance would not be sufficient to maintain the level of efficiency. The court observed that a utility is entitled to see that from the earnings the value of the property invested is kept up and repaired so that at the end of any given term of years the original investment remains as it was in the beginning.

"This naturally," continued the court, "calls for expenditures equal to the cost of the worn out equipment at the time of replacement; and this, for all practical purposes, means present value."

As a result of this decision many State Commissions will have to revise their policy with regard to estimating utility depreciation allowance, and by the same token many utilities all over the United States are at this time in a position to ask for an upward revision of their rate basis to conform with the holdings of the highest court respecting the depreciation allowance.

State Compelled to Allow Utility a Return Exceeding 7 Per Cent

THERE was yet another significant point made by the Baltimore Fare Case, published in full in this issue, which almost equals in importance the point about depreciation allowance discussed above. This was the determination of the amount of return to which the railway company was entitled. When the Baltimore Railway asked the Maryland Commission for the rate increase in the first instance that tribunal modified the proposed 10-cent fare on the ground that although the company might otherwise be legally entitled to a higher rate, as a matter of fact it could not be realized, even though the increase was granted, on account of the diminished patronage that would result from the increased rates.

"The only comparable undertaking," said Chairman West in rendering the opinion of the Commission in that proceeding, "attended by corresponding risks and uncertainties that this Commission knows of are those of other street railway companies in the East, and it does not know of such a company which is earning a return of much, if any, more than 6 per cent, no matter what the rate of fare."

In other words, the Commission felt that the utility was asking for rates which would exceed the value of the service and which would reach what is known in utility economics as the "point of diminishing return." The company appealed, contending that its own managers were in a better position to know whether or not the proposed increase would do the company any good than was the Commission. A lower Maryland court reversed the Commission, condemning what it termed as the tendency toward "paternalism" in governmental regulation.

The lower court's decision was in turn reversed by the Maryland court of appeals, which decided, with due regard to other factors in the case, that the utility should not be permitted to charge rates which would yield more than approximately 6.26 per cent return on the fair value of the company's property. The utility again appealed, this time to the highest court in the land.

Again the result of the appeal was a reversal, the United States Supreme Court deciding that anything less than 7.44 per cent return (which was the amount calculated to be produced by the 10-cent fare sought by the utility) would amount to confiscation in violation of the utility's right under the Federal Constitution.

A most significant remark of Justice Sutherland, in rendering the majority opinion of the court, was to the effect that an allowance of 7½ or even 8 per cent return by state regulatory bodies might be necessary in rate controversies in order to avoid restraining orders from Federal courts on grounds of confiscation.

The reason why this remark is so significant is that it seems to indicate the intention of the court in future cases to require State Commissions to allow rates yielding around 8 per cent. Of course, the majority opinion took care to point out that "what

will constitute a fair return in a given case is not capable of exact mathematical demonstration."

Nevertheless it had been the concensus of opinion prior to this decision that, while Federal courts had been holding as "reasonable" returns averaging around 8 per cent, these same courts would not go so far as to hold "confiscatory" a return much in excess of 6 per cent. This decision held as confiscatory a return of 6.26 per cent and limited its findings of reasonableness to 7.44 per cent only because that happened to be all that the utility had asked the Commission for in the first place.

It would seem to follow from this that there is not much difference after all between "unreasonableness" and "confiscation" so far as Federal restraining orders are concerned, and furthermore that many utilities in this country now operating at rates fixed by State Commissions yielding less than 7½ and 8 per cent returns are in a position to seek relief from Federal courts.

How White Is the Great White Way?

THERE is one man in New York who knows at all times just what hours Father Knickerbocker is keeping. He is accurately aware of quiet evenings. He knows when New Yorkers as a whole retire early. He knows when the whole city celebrates and how long and how hard they do it. He has his finger on the public pulse and can tell at any given moment of the night just how white is the great white way.

Who is this omniscient person? It's not Mayor Walker notwithstanding the profound knowledge which the popular young city father has about his millions of children. Nor is it Commissioner Whalen, notwithstanding the vigilance of this police executive in keeping these same millions on the straight and narrow path of civic virtue. It isn't Al Smith or Major La Guardia. It is a humble and comparatively obscure gentleman who sits at the central power control board of the New York Edison Company and keeps an ever open eye on the numerous meters, gauges, and other gadgets that tell to the fraction of a kilowatt just how much "whoopee" New Yorkers are making.

Here is an example of the story that this central control board told on New Year's Eve. The citizens of Manhattan, the Bronx, Brooklyn, Queens, and Yonkers, celebrated this festival until 5 o'clock in the morning and the following figures prove it. The consumption of electricity that night was 461,000 kilowatt hours *in excess* of the consumption for the same period on the previous night which equals approximately the use of 9,220,000 fifty-watt lamps burning one hour, which laid end to end would make a line nearly eight hundred miles long.

The New Year's load started to rise at 10:30 P. M., December 31, 1929, and at midnight it reached its peak which was 113,000 kilowatts higher than the preceding midnight.

The peak held almost constant until 1 A. M. when it dropped slowly to 2 A. M. after which it dropped more swiftly until 5 A. M. when it reached the consumption figure of the same hour the day before.

This tremendous fluctuation in the load factor of an electric utility for a single festival serves to give one a vague idea as to necessary amount of standby plant investment required to serve the needs of the metropolis.

A New Move for the Solution of the New York Water Power Tangle

ANOTHER significant development of the past month has been what appears to be the first definite break in the New York state water power impasse. For many years there has existed in the Empire State an immovable deadlock between the Democratic and Republican parties concerning just what should be the policy of the state regarding the development of state owned hydroelectric sites.

The Democrats, led first by Governor Alfred E. Smith, and now by his chosen successor Governor Franklin D. Roosevelt, have been firmly convinced that these sites should remain the property in fact of the people of New York state, and have proposed construction and operation of all the generating facilities by the state, conceding the transmission and distribution of electric power thus generated to privately owned utilities.

The Republican forces, having a majority control of the legislature but not to the extent sufficient to over-ride the executive veto, have heretofore been equally firm in the conviction that the entire development should be operated and controlled by private enterprise through long-term leases from the state.

As the Democrats have been consistently successful in capturing the gubernatorial chair, and as the Republicans have been equally successful in retaining their control of the legislature, these opposing forces have blockaded each other's measures so regularly that it was the concensus of opinion that there would be no break until either the Republicans elected a Governor or the Democrats secured control of both houses. Meantime there has been no development and much unexploited water has flowed out of the St. Lawrence river during the last ten years.

The latest action in the matter apparently came very unexpectedly. The majority party has proposed a measure purporting, according to its leaders, to "lift the water power problem out of politics." This was to be accomplished through the appointment by the Governor of five commissioners to consider the entire situation and report their conclusions for appropriate legislative action. The bill does not tie the investigation up with any scheme but does admit the possibility of the state developing electric power and selling it by contract to distributing companies. The first two sections of the bill would enact as follows:

"SECTION I.—The natural water power sites in, upon, or adjacent to the St. Lawrence river, owned or con-

trolled by the people or which may hereafter be recovered by them or come within their ownership and control, shall remain inalienable to, and ownership and control shall remain always vested in, the people.

"SECTION 2.—The Governor of the state shall appoint five commissioners to study and report plans for the development and a form of contract for the sale of hydroelectric power to be generated at water power sites on the St. Lawrence river owned or controlled by the people of the state. Such report shall be made to the Governor and the legislature not later than January 15, 1931."

On the other hand the bill leaves the final say on the matter with the legislature.

Whether this is a real step towards the solution of the long drawn out feud or whether it is just another political blind alley can only be determined when the Commission has made its report and when the legislature and the Governor have acted upon it. Meantime a great amount of water is still flowing through the St. Lawrence unmolested, and hydraulic projects are held in abeyance.

Separate Public Corporations Are Urged for the Rendition of Utility Service

For many years we have been used to hearing about the "dual" capacity of a municipal corporation. In its public activities, such as passing police ordinances, it is said to function in its governmental capacity. In its private activities, such as operating a utility plant, it is said to function in its proprietary capacity. This splitting of the corporate character of a municipality has led to much litigation and corresponding splitting of legal hairs. Many lawyers have come to regard it as a very clumsy and awkward way of attempting to do business.

Now comes a suggestion from Attorney General C. A. Sorenson of Nebraska in an address to the League of Nebraska Municipalities that we do away with the so-called dual capacity by permitting a municipality or any other group of citizens to form a separate corporate entity for the sole purpose of rendering utility service just as such inhabitants are at present permitted to form separate corporate entities in the form of fire, water, and sewer districts.

The idea is not novel. During the war when Congress found it advisable to subsidize the American merchant marines, it was also found inadvisable to put Uncle Sam into the shipping business under his right name. So Congress disguised him as a company known as the Emergency Fleet Corporation, which was controlled by the United States, but which had a separate legal existence and enjoyed the same powers and privileges as any other corporation. This method was found far more flexible and efficient in handling the situation.

Now when we consider the sovereign state we find that it is divided into a number of public corporations known as counties, which are in turn divided into a number of other sepa-

rate public corporations known as the cities, towns, and incorporated villages. In addition to this we have separate entities incorporated by the inhabitants of particular areas for the purpose of providing fire protection. Such a corporation is known as a fire district. It has its borders which are legally independent of the borders of a city or town, although they may and frequently do coincide with the latter. In other words, it is possible to have two or more towns in one fire district, or two or more fire districts in one town. The fire district is a distinct public corporation in the eyes of the law existing solely for fire protection.

This method has long since been applied to water and sewer service, but its use in the matter of power and light is less than widespread. Mr. Sorenson urges this method as a more flexible means of permitting the extension of utility service by governmental agencies which are more or less hampered by inaccessible corporate boundaries. He stated:

> "Municipalities which own and operate electric light and power plants ought to be permitted by law, under proper safeguards, to sell current outside the town limits, build and operate transmission lines, and interconnect with other publicly-owned power plants. Private power companies have this right; why not the cities and towns?
>
> "Thousands of farmers living in proximity to municipal power plants have a special interest in this matter. If cities and towns are not granted the right to operate outside their boundary lines, then these farmers are practically barred from ever securing light and power because no private power company just to serve a few farmers will build lines up to the limits of a town it cannot hope to serve."

Mr. Sorenson, in explaining the proposed legislation that would permit the formation of public electric light and power districts by cities and other subdivisions in Nebraska, described in detail the way in which these utilities should be organized and enumerated the various powers and advantages that would accrue from such organizations. He proposed that a petition signed by 10 per cent of the voters of each of the governmental subdivisions to be included in such a district should require the State Department of Public Works to investigate and report upon the feasibility of the proposition, and that if a favorable report should be made the matter should be submitted to a vote of the citizens of the proposed district, and that a majority vote would decide the issue.

Mr. Sorenson's proposals are particularly significant at this time in that it indicates the possibility of building up huge utility corporations owned and operated by governmental agencies through the consolidation of smaller districts into larger ones. In this way it may be possible, legally at least, to have a single public owned corporation operating throughout an entire state and it shows that such governmental operations need not be confined, as heretofore, to an area occupied by a single community.

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COMPRISING THE DECISIONS, ORDERS, AND RECOMMENDATIONS OF COURTS AND COMMISSIONS

VOLUME 1930A NUMBER 3

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v.

Harold E. West et al.

[No. 55.]

Harold E. West et al.

v.

United Railways and Electric Company of Baltimore

[No. 64.]

(— U. S. —, — L. ed. —, — Sup. Ct. Rep. —.)

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Depreciation — Basis for computation — Present value.

8. The allowance for annual depreciation of a utility company must be based upon the present fair value of the property involved and not upon the original cost thereof, p. 231.

Depreciation —Basis for computation — Present fair value.

9. It is wholly illogical to adopt a different rule for computing the basis of annual utility depreciation allowance than for otherwise computing the fair value of the property for rate-making purposes, p. 231.

[BRANDEIS, HOLMES, and STONE, JJ., dissent.]

[January 6, 1930.]

APPEAL *by a street railway company from a decree of the Court of Appeals of Maryland sustaining in part a rate order of the Maryland Commission and a cross-appeal by the Maryland Commission from the same decree; decree reversed and cause remanded for further proceedings sustaining the utility; cross-appeal dismissed.*

Mr. Justice SUTHERLAND delivered the opinion of the Court: The first of these titles (No. 55) is an appeal, and the second (No. 64) a cross-appeal, from a decree of the court of appeals of Maryland. The case arose from an order of the State Public Service Commission limiting the rate of passenger fares to be charged by the United Railways & Electric Company for carrying passengers over its lines in the city of Baltimore. The company, by its appeal, attacks the Commission's order as confiscatory. The cross-appeal seeks to raise the question whether the amount for annual depreciation allowed the company should be calculated upon the present value of the company's property or upon its cost.

Upon application of the company to the Commission, made in 1927, P.U.R.1928C, 604, for an increase in fares, the Commission passed an or-

der making an increase, but not to the extent sought. Thereupon, suit was brought in a state circuit court on the grounds that the rate fixed by the Commission was confiscatory and that the annual allowance for depreciation was calculated upon a wrong basis, namely, upon cost, instead of present value of depreciable property. The circuit court, in an able opinion, sustained the company upon both grounds, and enjoined the enforcement of the Commission's order. On appeal, the court of appeals upheld the view of the circuit court in respect of depreciation, but held the rate of return not confiscatory. (1928) 155 Md. 572, P.U.R.1928D, 141, 193, 142 Atl. 870. Thereupon, the Commission increased the depreciation allowance in accordance with the decree of the court and adjusted the rate of fare to the extent necessary to absorb the increased allowance. A second suit and an appeal to the court of appeals followed, and that court entered a decree (1929) — Md. —, P.U.R.1929B, 467, 145 Atl. 340, sustaining the action of the Commission; and it is that decree which is here for review.

The facts, so far as we find it necessary to review them, are not in dispute. The company since 1899 has owned and operated all the street railway lines in the city of Baltimore. Its present capital structure consists of $24,000,000 of common stock, $38,000,000 of ordinary bonded indebtedness, and $14,000,000 of perpetual income bonds redeemable at the option of the company after 1949. Due to the increased use of automobiles, the total number of passengers carried has for some time steadily decreased, while the number carried during the "rush hours" has increased. This has resulted in an increase of expenses in proportion to the whole number of passengers carried, since equipment, etc., must be maintained and men employed sufficient to care for the increased business of the "rush hours," notwithstanding their reduced productiveness during the hours of decreased business. Since the war operating expenses have almost if not quite doubled.

The present value of the property used was fixed by the Commission at $75,000,000, and this amount was accepted without question by both parties in the state circuit court and in the court of appeals. Included in this valuation is $5,000,000 for easements in the streets of Baltimore. The court of appeals had held in another and earlier case, Miles v. Public Service Commission (1926) 151 Md. 337, P.U.R.1926D, 610, 135 Atl. 579, that the easements constituted an interest in real estate and that in making up the rate base their value should be included. The Commission in the present case, accordingly, included the amount in the valuation and made no attack upon the item in the courts below, where it passed as a matter not in dispute.

[1] The item is now challenged by counsel for the Commission in this court, and other objections to the valuation are suggested, likewise for the first time. We do not find it necessary to consider this challenge or these objections, for, if they ever possessed substance, they come too late. In the further consideration of the case, therefore, we accept, for all

purposes, the valuation of $75,000,000 as it was accepted and acted upon by parties, Commission, and courts below.

[2] The Commission fixed a rate of fare permitting the company to earn a return of 6.26 per cent on this valuation; and, so far as No. 55 is concerned, the case resolves itself into the simple question whether that return is so inadequate as to result in a deprivation of property in violation of the due process of law clause of the Fourteenth Amendment. In answering that question, the fundamental principle to be observed is that the property of a public utility, although devoted to the public service and impressed with a public interest, is still private property; and neither the corpus of that property nor the use thereof constitutionally can be taken for a compulsory price which falls below the measure of just compensation. One is confiscation no less than the other.

[3] What is a fair return within this principle cannot be settled by invoking decisions of this court made years ago based upon conditions radically different from those which prevail today. The problem is one to be tested primarily by present-day conditions. Annual returns upon capital and enterprise, like wages of employees, cost of maintenance, and related expenses, have materially increased the country over. This is common knowledge. A rate of return upon capital invested in street railway lines and other public utilities which might have been proper a few years ago no longer furnishes a safe criterion either for the present or the future. Lincoln Gas & E. L. Co. v. Lincoln (1919) 250 U. S. 256, 268, 63 L. ed. 968, 39 Sup. Ct. Rep. 454. Nor can a rule be laid down which will apply uniformly to all sorts of utilities. What may be a fair return for one may be inadequate for another, depending upon circumstances, locality, and risk. Willcox v. Consolidated Gas Co. (1909) 212 U. S. 19, 48–50, 53 L. ed. 382, 29 Sup. Ct. Rep. 192, 48 L.R.A. (N.S.) 1134, 15 Ann. Cas. 1034. The general rule recently has been stated in Bluefield Water Works & Improv. Co. v. Public Service Commission (1923) 262 U. S. 679, 692–695, 67 L. ed. 1176, P.U.R.1923D, 11, 20, 43 Sup. Ct. Rep. 675.

"What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate

of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market, and business conditions generally.

. . . . . .

"Investors take into account the result of past operations, especially in recent years, when determining the terms upon which they will invest in such an undertaking. Low, uncertain or irregular income makes for low prices for the securities of the utility and higher rates of interest to be demanded by investors. The fact that the company may not insist as a matter of constitutional right that past losses be made up by rates to be applied in the present and future tends to weaken credit, and the fact that the utility is protected against being compelled to serve for confiscatory rates tends to support it. In this case the record shows that the rate of return has been low through a long period up to the time of the inquiry by the Commission here involved."

What will constitute a fair return in a given case is not capable of exact mathematical demonstration. It is a matter more or less of approximation about which conclusions may differ. The court in the discharge of its constitutional duty on the issue of confiscation must determine the amount to the best of its ability in the exercise of a fair, enlightened, and "independent judgment as to both law and facts." Ohio Valley Water Co. v. Ben Avon (1920) 253 U. S. 287, 289, 64 L. ed. 908, P.U.R.1920E, 814, 40 Sup. Ct. Rep. 527; Bluefield Water Works & Improv. Co. v. Public Service Commission, *supra*, pp. 689, 692; Lehigh Valley R. Co. v. Public Utility Comrs. (1928) 278 U. S. 24, 36, 73 L. ed. —, P.U.R.1929A, 209, 49 Sup. Ct. Rep. 69.

There is much evidence in the record to the effect that in order to induce the investment of capital in the enterprise or to enable the company to compete successfully in the market for money to finance its operations, a net return upon the valuation fixed by the Commission should be not far from 8 per cent. Since 1920, the company has borrowed from time to time some $18,000,000, upon which it has been obliged to pay an average rate of interest ranging well over 7 per cent and this has been the experience of street railway lines quite generally.

[**4**] Upon the valuation fixed, with an allowance for depreciation calculated with reference to that valuation, and upon the then prescribed rates, the company for the years 1920 to 1926, both inclusive, obtained a return of little more than 5 per cent per annum. It is manifest that just compensation for a utility, requiring for efficient public service skillful and prudent management as well as use of the plant, and whose rates are subject to public regulation, is more than current interest on mere investment. Sound business management requires that after paying all expenses of operation, setting aside the necessary sums for depreciation, payment of interest and reasonable dividends, there should still remain something to be passed to the surplus account; and a rate of return which does not admit of that being done is not sufficient to assure confidence in the financial soundness of the utility to maintain its credit and enable it to raise money necessary for the proper discharge of its public duties.

[5, 6] In this view of the matter, a return of 6.26 per cent is clearly inadequate. In the light of recent decisions of this court and other Federal decisions, it is not certain that rates securing a return of 7½ per cent or even 8 per cent on the value of the property would not be necessary to avoid confiscation.[1] But this we need not decide, since the company itself sought from the Commission a rate which it appears would produce a return of about 7.44 per cent, at the same time insisting that such return fell short of being adequate. Upon the present record, we are of opinion that to enforce rates producing less than this would be confiscatory and in violation of the due process clause of the Fourteenth Amendment.

Complaint also is made of the action of the Commission in abolishing the second fare zone established by the company on what is called the Halethorpe line and substituting a single fare for the two fares theretofore exacted. Halethorpe is an unincorporated community lying outside the limits of Baltimore city.

[7] With a single fare, the extension of the line to Halethorpe is not profitable, but, nevertheless, it is an integral part of the railway system, and it will be enough if the Commission shall so readjust the fares as to yield a fair return upon the property, including the Halethorpe line, as a whole. If, in doing so, the Commission shall choose, not to restore the second fare, but to retain in force the single fare, we perceive no constitutional objection.

The Commission sought a review of the question in respect of the annual depreciation allowance, both by a cross-appeal and, later, by petition for certiorari. The question of jurisdiction on the cross-appeal as well as the consideration of the petition for certiorari were postponed to the hearing on the merits. We do not now find it necessary to decide either matter. As the amount of depreciation to be allowed was contested throughout, is a necessary element to be determined in fixing the rate of fare, and is closely related in substance to the case brought here by the company's appeal, it well may be considered in connection therewith. In these circumstances neither cross-appeal nor certiorari is necessary to present the question.

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[1]See, for example, Galveston Electric Co. v. Galveston (1922) 258 U. S. 388, 400, 66 L. ed. 678, P.U.R.1922D, 159, 42 Sup. Ct. Rep. 351; Brush Electric Co. v. Galveston (1923) 262 U. S. 443, 67 L. ed. 1076, P.U.R. 1923D, 573, 43 Sup. Ct. Rep. 606; Fort Smith v. Southwestern Bell Teleph. Co. (1926) 270 U. S. 627, 70 L. ed. 768, 46 Sup. Ct. Rep. 206, affirming *per curiam* Southwestern Bell Teleph. Co. v. Fort Smith (1923) 294 Fed. 102, 108, P.U.R.1924E, 662; Patterson v. Mobile Gas Co. (1926) 271 U. S. 131, 70 L. ed. 870, P.U.R.1926D, 183, 46 Sup. Ct. Rep. 445, affirming in part Mobile Gas Co. v. Patterson (1923) 293 Fed. 208, 221, P.U.R.1924B, 644; McCardle v. Indianapolis Water Co. (1926) 272 U. S. 400, 419, 71 L. ed. 154, P.U.R.1927A, 15, 47 Sup. Ct. Rep. 144 and note; Ottinger v. Brooklyn Union Gas Co. (1926) 272 U. S. 579, 71 L. ed. 249, P.U.R. 1927A, 39, 47 Sup. Ct. Rep. 199, modifying and affirming Kings County Lighting Co. v. Prendergast (1925) 7 F. (2d) 192, P.U.R. 1925C, 705, P.U.R.1925E, 5, and Brooklyn Union Gas Co. v. Prendergast (1925) 7 F. (2d) 628, P.U.R.1926A, 412; Minnesota R. & Warehouse Commission v. Duluth Street R. Co. (1927) 273 U. S. 625, 71 L. ed. 807, P.U.R.1927B, 712, 47 Sup. Ct. Rep. 489, affirming Duluth Street R. Co. v. Minnesota R. & Warehouse Commission (1924) 4 F. (2d) 543, P.U.R.1925D, 226; Minneapolis v. Rand (1923) 285 Fed. 818, 830; New York Teleph. Co. v. Prendergast (1924) 300 Fed. 822, 826, P.U.R.1925A, 491; id. (1926) 11 F. (2d) 162, 163, P.U.R.1926C, 696; New York & Richmond Gas Co. v. Prendergast (1925) 10 F. (2d) 167, 209, P.U.R.1925E, 19, P.U.R. 1926B, 759.

[8] The allowance for annual depreciation made by the Commission was based upon cost. The court of appeals held that this was erroneous and that it should have been based upon present value. The court's view of the matter was plainly right. One of the items of expense to be ascertained and deducted is the amount necessary to restore property worn out or impaired, so as continuously to maintain it as nearly as practicable at the same level of efficiency for the public service. The amount set aside periodically for this purpose is the so-called depreciation allowance. Manifestly, this allowance cannot be limited by the original cost, because, if values have advanced, the allowance is not sufficient to maintain the level of efficiency. The utility "is entitled to see that from earnings the value of the property invested is kept unimpaired, so that at the end of any given term of years the original investment remains as it was at the beginning." Knoxville v. Knoxville Water Co. (1909) 212 U. S. 1, 13, 14, 53 L. ed. 371, 29 Sup. Ct. Rep. 148.

[9] This naturally calls for expenditures equal to the cost of the worn out equipment at the time of replacement; and this, for all practical purposes, means present value. It is the settled rule of this court that the rate base is present value, and it would be wholly illogical to adopt a different rule for depreciation. As the supreme court of Michigan, in Michigan Pub. Utilities Commission v. Michigan State Teleph. Co. (1924) 228 Mich. 658, 666, P.U.R.1925C, 158, 163, 200 N. W. 749, has aptly said: "If the rate base is present fair value, then the depreciation base as to depreciable property is the same thing. There is no principle to sustain a holding that a utility may earn on the present fair value of its property devoted to public service, but that it must accept and the public must pay depreciation on book cost or investment cost regardless of present fair value. We repeat, the purpose of permitting a depreciation charge is to compensate the utility for property consumed in service, and the duty of the Commission, guided by experience in rate making, is to spread this charge fairly over the years of the life of the property." And see Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Service Commission (1923) 262 U. S. 276, 288, 67 L. ed. 981, P.U.R.1923C, 193, 43 Sup. Ct. Rep. 544, 31 A.L.R. 807; Georgia R. & Power Co. v. Railroad Commission (1923) 262 U. S, 625, 633, 67 L. ed. 1144, P.U.R.1923D, 1, 43 Sup. Ct. Rep. 680.

We conclude that an injunction should have been granted against the Commission's order.

Mr. Justice BRANDEIS, dissenting: Acting under the direction of the court of appeals, Public Service Commission v. United R. & Electric Co. (1928) 155 Md. 572, P.U.R.1928D, 141, 142 Atl. 870, the Commission entered, on November 28, 1928, P.U.R.1929A, 180, an order permitting the Railways to increase its rate of fare to 10 cents cash, four tokens for 35 cents.[1] That order was sus-

[1]The rate of fare on the Railways' lines had been 5 cents until 1918. Then it applied for authority to increase its fares "purely as a war emergency and during the period of war conditions." Six increases have since been granted: to 6 cents on January 7, 1919.

tained in United R. & Electric Co. v. West (1929) — Md. —, P.U.R. 1929B, 467, 145 Atl. 340, and the Railways has appealed to this court. The claim is that the order confiscates its property because the fare fixed will yield, according to the estimates, no more than 6.26 per cent upon the assumed value. There are several reasons why I think the order should be held valid.

A net return of 6.26 per cent upon the present value of the property of a street railway enjoying a monopoly in one of the oldest, largest and richest cities on the Atlantic Seaboard would seem to be compensatory. Moreover, the estimated return is in fact much larger, if the rules which I deem applicable are followed. It is 6.70 per cent if, in valuing the rate base, the prevailing rule which eliminates franchises from a rate base is applied. And it is 7.78 per cent if also, in lieu of the deduction for depreciation ordered by the court of appeals, the amount is fixed, either by the method of an annual depreciation charge computed according to the rules commonly applied in business, or by some alternative method, at the sum which the long experience of this railway proves to have been adequate for it.

First. The value of the plant adopted by the Commission as the rate base was fixed by it at $75,000,000 in a separate valuation case, decided on March 9, 1926, modified, pursuant to directions of the court of appeals,[2] on February 1, 1928, and not before us for review, Re United R. & Electric Co., P.U.R.1926C, 441, P.U.R.1928B, 737. Included in this total is $5,000,000 representing the value placed upon the Railways' so-called "easements." If they are excluded, the estimated yield found by the Commission would be increased by .44 per cent. That is, the net earnings, estimated at $4,691,606 would yield, on a $70,000,000 rate base, 6.70 per cent. The people's counsel contended that since these "easements" are merely the privileges gratuitously granted to the Railways by various county and municipal franchises to lay tracks and operate street cars on the public highways,[3] they should be excluded from the rate base when considering whether the order is confiscatory in violation of the Federal Constitution. This alleged error of Federal law in the valuation may be considered on this appeal. For, the rate allowed by the Commission is attacked on the assumption that the return on the property is only 6.26 per

Re United R. & Electric Co. P.U.R.1919C, 74; to 7 cents cash, four tokens for 26 cents, on September 30, 1919, Re United R. & Electric Co. P.U.R.1920A, 1; to a flat 7 cents on December 31, 1919, Re United R. & Electric Co. (anno.) P.U.R.1920A, 995; to 8 cents, two tokens for 15 cents, on May 26, 1924, Re United R. & Electric Co. P.U.R.1924D, 713. This was the rate of fare when, on August 1, 1927, the Railways filed with the Commission the present application for a flat 10 cent fare. In its original decision thereon the Commission authorized a fare of 9 cents cash, three tokens for 25 cents, on Feb. 10, 1928, Re United R. & Electric Co. P.U.R. 1928C, 604. To provide the additional revenue required by the decision of the court of appeals concerning depreciation, the Commission then raised the fare to 10 cents cash, four tokens for 35 cents, on Nov. 28, 1928, Re United R. & Electric Co. P.U.R.1929A, 180. The Railways is still seeking to secure a flat 10 cent fare. The Railways had by order of the Commission been protected from jitney competition. See P.U.R.1928C, 604, 632.

[2]Miles v. Public Service Commission (1926) 151 Md. 337, P.U.R.1926D, 610, 135 Atl. 579.

[3]A small part of these "easements" are

cent.[4] Compare United States v. American R. Express Co. (1924) 265 U. S. 425, 435, 68 L. ed. 1087, 44 Sup. Ct. Rep. 560; Union Tool Co. v. Wilson (1922) 259 U. S. 107, 111, 66 L. ed. 848, 42 Sup. Ct. Rep. 427.

Where a rate order is alleged to be void under the Federal Constitution because confiscatory, the question whether a specific class of property should be included in the rate base is to be determined not by the state law, but by the Federal law. Whether the return is sufficient under the state law is a question which does not concern us. We are concerned solely with the adequacy or inadequacy of the return under the guarantees of the Federal law. In determining whether a prescribed rate is confiscatory under the Federal Constitution, franchises are not to be included in valuing the plant, except for such amounts as were actually paid to the state, or a political subdivision thereof, as consideration for the grant. Cedar Rapids Gas Light Co. v. Cedar Rapids (1912) 223 U. S. 655, 669, 56 L. ed. 594, 32 Sup. Ct. Rep. 389; Des Moines Gas Co. v. Des Moines (1915) 238 U. S. 153, 169, 59 L. ed. 1244, P.U.R.1915D, 577, 35 Sup. Ct. Rep. 811; Galveston Electric Co. v. Galveston (1922) 258 U. S. 388, 396, 66 L. ed. 678, P.U.R.1922D, 159, 42 Sup. Ct. Rep. 351; Georgia R. & Power Co. v. Railroad Commission (1923) 262 U. S. 625, 632, 67 L. ed. 1144, P.U.R.1923D, 1, 43 Sup. Ct. Rep. 680.[5] Franchises to lay pipes or tracks in the public streets, like franchises to conduct the business as a corporation, are not donations to a utility of property by the use of which profit may be made. They are privileges granted to utilities to enable them to employ their property in the public service and make profit out of such use of that property. As stated in the New Hampshire statute, "all such franchises, rights, and privileges being granted in the public interest only" are "not justly subject to capitalization against the public."[6]

Had the "easements" been called franchises it is probable that no value would have been ascribed to them for rate-making purposes. For the Maryland public utilities law, in common with the statutes of many states,[7] forbids the capitalization of franchises. But calling these privileges "ease-

privileges granted by franchises to operate street cars on portions of the streets which the public uses only at intersections with other streets.

[4]The Commission's opinions and orders in the valuation proceeding are referred to in the several pleadings and are printed as part of the record in this case.

[5]Also Westinghouse Electric & Mfg. Co. v. Denver Tramway Co. (1924) 3 F. (2d) 285, 302, P.U.R.1925B, 156, affirmed sub nom. Denver v. Denver Tramway Corp. (1927) 23 F. (2d) 287; Public Utilities Commission v. Capital Traction Co. (1927) 17 F. (2d) 673, 675, 6; Re Capital City Teleph. Co. (Mo. 1928) P.U.R.1928D, 763, 766, 776; Re Tracy Gas Co. (Cal. 1926) P.U.R.1927C, 177, 181; Re Southern P. Co. (Or. 1925) P.U.R.1926A, 298, 303; Re Potomac Electric Power Co. (D. C. 1917) P.U.R.1917D, 563, 680. No case has been found which accepts the rule laid down by the court of appeals.

[6]*New Hampshire*—P. L. 1926, Vol. 2, ch. 241, § 10, p. 943.

[7]*Arizona*—Rev. Stat. 1913, § 2328(b), p. 811; *California*—Public Utilities Law, § 52b, Deering Codes & Gen. L. Supp. 1925-1927, Act 6386, § 52(b), p. 1811; *Idaho*—Comp. Stat. 1919, Vol. 1, § 4290, p. 1221; *Illinois*—Cahill's Rev. Stat. 1929, Ch. 11a, § 36, p. 2047; *Indiana*—Burns' Ann. Stat. 1926, Vol. 3, § 12763, p. 1258; *Maryland*—Bagby's Ann. Code, 1924, Vol. 1, Art. 23, § 381, p. 832; *Missouri*—Rev. Stat. 1919, Vol. 3, §§ 10466, 10484, 10508, pp. 3425, 3262, 3279; *Nebraska*—Comp. Stat. 1922, § 676, p. 321, amended by L. 1925, ch. 141; *New Hampshire*—P. L. 1926, Vol. 2, ch. 241, § 10, p. 943; *New Jersey*—1911-1924, Cum. Supp. to Comp. Stat. Vol 2, *167-24, p. 2886; *New York*—Cahill's

ments" does not differentiate them for rate purposes from ordinary corporate franchises, when applying the Federal Constitution. In none of the cases excluding franchises from plant value was any distinction made, in this respect, between ordinary corporate franchises and franchises to use the public streets, although many of the cases involved privileges of the latter type. The court of appeals and the Commission were influenced by the fact that the so-called "easements" were taxed. This fact does not justify including them in the rate base. Corporate franchises are frequently taxed;[8] and although taxed, are not valued for rate purposes. Compare Georgia R. & Power Co. v. Railroad Commission (1922) 278 Fed. 242, 244, 5, P.U.R.1922C, 744. The "easements" differ from ordinary franchises only in the technicality that, under the law of Maryland, the right to use the streets is, for taxation purposes, real property, whereas ordinary franchises are personal property.

Second. The amount which the Commission fixed, in its original report, as the appropriate depreciation charge was $883,544. That sum is 5 per cent of the estimated gross revenues. Referring to the method of arriving at the amount of the charge the Commission there said: "The Commission believes that it might be more logical to base the annual allowance for depreciation upon the cost of depreciable property, rather than upon gross revenues. The relation between gross revenues and depreciation is remote and indirect while there is a direct relation between the cost of a piece of property and the amount that ought to be set aside for its consumption by use. However, the allowance which this Commission has made for depreciation, 5 per cent of the gross revenues, has provided fairly well for current depreciation and retirements. . . . Moreover, there is a broad twilight zone between depreciation and maintenance, and it may well be (and without any impropriety) that the maintenance account has been used to a certain extent to provide for depreciation. . . . Any increase in the gross revenues resulting from an increase in fares would increase the amounts that would be set aside for depreciation and maintenance."[9] Without deciding that this allowance was inadequate, the court of appeals held that, as a matter of law, the depreciation charge should be based upon the then value of the depreciable property as distinguished from its cost; and directed the Commission to revise its estimates accordingly. Pursuant to that direction, the Commission added, in its supplemental report, $755,116

Cons. L. 1923, ch. 49, §§ 69, 101, pp. 1746, 1759; 1929 Supp. ch. 49, §§ 55, 82, pp. 282, 283; *Pennsylvania*—Stat. 1920 (West Pub. Co.) § 18095, p. 1745. Some of the statutes, in addition to prohibiting the capitalization of franchises, specifically direct that no franchise shall be valued for rate-making purposes: *Iowa*—Code 1927, § 8315, p. 1076; *Minnesota*—Gen. Stat. 1923, Chap. 28, § 4823, p. 683; § 5304, p. 733; *North Dakota*—Supp. to Comp. Laws, 1913–1925, ch. 13B, § 4609c37, p. 969; § 4609c40, p. 971; *Ohio*—Throckmorton's Ann. Code, 1929, §§ 614-23, 614-46, 614-59, pp. 156, 160, 164; *Wisconsin*—Stat. 1925, Vol. 1, 184.15, p. 1446.

[8] Society For Savings v. Coite (1868) 6 Wall. 594, 18 L. ed. 897; Cream of Wheat Co. v. Grand Forks (1920) 253 U. S. 325, 328, 64 L. ed. 931, 40 Sup. Ct. Rep. 558; Roberts & Schaefer Co. v. Emmerson (1926) 271 U. S. 50, 55, 70 L. ed. 827, 46 Sup. Ct. Rep. 375.

[9] P.U.R.1928C, 604, 637, 640, 641.

to the depreciation charge. The addition was, I think, ordered by the court of appeals under a misapprehension of the nature and function of the depreciation charge. And, in considering the adequacy of the return under the Federal Constitution, the estimate of the net earnings should accordingly be increased by $755,116, which, on the rate base of $70,000,000, would add 1.08 per cent to the estimated return.

That the court of appeals erred in its decision becomes clear when the nature and purpose of the depreciation charge are analyzed and the methods of determining its proper amount are considered. The annual account of a street railway, or other business, is designed to show the profit or loss, and to acquaint those interested with the condition of the business. To be true, the account must reflect all the operating expenses incurred within the accounting period. One of these is the wearing out of plant. Minor parts, which have short lives and are consumed wholly within the year, are replaced as a part of current repairs.[10] Larger plant units, unlike supplies, do not wear out within a single accounting period. They have varying service lives, some remaining useful for many years. Experience teaches that at the end of some period of time most of these units, too, will wear out physically or cease to be useful in the service. If the initial outlay for such units is entirely disregarded, the annual account will not reflect the true results of operation and the initial investment may be lost. If, on the other hand, this original expense is treated as part of the operating expenses of the year in which the plant unit was purchased, or was retired or replaced, the account again will not reflect the true results of operation. For operations in one year will then be burdened with an expense which is properly chargeable against a much longer period of use. Therefore, in ascertaining the profits of a year, it is generally deemed necessary to apportion to the operations of that year a part of the total expense incident to the wearing out of plant. This apportionment is commonly made by means of a depreciation charge.[11]

It is urged by the Railways that if the base used in determining what is a fair return on the use of its property is the present value, then logically the base to be used in determining the depreciation charge—a charge for the consumption of plant in service—must also be the present value of the

[10]Compare Classification of Operating Revenues and Operating Expenses of Steam Roads prescribed by Interstate Commerce Commission, issue of 1914, Special Instructions No. 2, p. 31. As to practice of the telephone companies (Bell system), see testimony on rehearing of Telephone and Railroad Depreciation Charges (1926) 118 Inters. Com. Rep. 295, Docket Nos. 14700 and 15100, L. G. Woodford, March 19, 1928 (Printed by American Tel. & Tel. Co.), pp. 52-3.

[11]The depreciation charge or allowance is the annual or monthly amount thus apportioned as the year's equitable share of the expense of ultimate retirement of plant. The yearly charge is by many concerns allocated in monthly instalments. A depreciation reserve is a bookkeeping classification to which the depreciation charges are periodically credited. A depreciation fund is a fund separately maintained in which amounts charged for depreciation are periodically deposited. A depreciation reserve does not necessarily connote the existence of a separate fund. E. A. Saliers, Depreciation, Principles and Applications (1923) 80; W. A. Paton and R. A. Stevenson, Principles of Accounting (1918) 491-505.

property consumed.[12] Much that I said about valuation in Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Service Commission (1923) 262 U. S. 276, 289, 67 L. ed. 981, P.U.R.1923C, 193, 43 Sup. Ct. Rep. 544, 31 A.L.R. 807, and St. Louis & O'Fallon R. Co. v. United States (1929) 279 U. S. 461, 488, 73 L. ed. —, P.U.R.1929C, 161, 49 Sup. Ct. Rep. 384, applies to the depreciation charge. But acceptance of the doctrine of Smyth v. Ames (1898) 169 U. S. 466, 42 L. ed. 819, 18 Sup. Ct. Rep. 418, does not require that the depreciation charge be based on present value of plant. For, an annual depreciation charge is not a measure of the actual consumption of plant during the year. No such measure has yet been invented. There is no regularity in the development of depreciation. It does not proceed in accordance with any mathematical law. There is nothing in business experience, or in the training of experts, which enables man to say to what extent service life will be impaired by the operations of a single year, or of a series of years less than the service life.[13]

Where a plant intended, like a street railway, for continuing operation is maintained at a constant level of efficiency, it is rarely possible to determine definitely whether or not its service life has in fact lessened within a particular year. The life expectancy of a plant, like that of an individual, may be in fact greater, because of unusual repairs or other causes, at the end of a particular year than it was at the beginning.[14] And even where it is known that there has been some lessening of service life within the year, it is never possible to determine with accuracy what percentage of the unit's service life has, in fact, been so consumed. Nor is it essential to the aim of the charge that this fact should be known. The main purpose of the charge is that irrespective of the rate of depreciation there shall be produced, through annual contributions, by the end of the service life of the depreciable plant, an amount equal

[12]If the depreciation charge measured the actual consumption of plant, the logic of this conclusion might seem forceful. It should be pointed out, therefore, that, apart from the fact developed in the text, that the charge does not measure the actual consumption of plant, the contention is specious. A business man investing in a long-lived plant does not expect to have its value returned to him in instalments corresponding to the loss of service life. The most that a continuing business like a street railway may expect is that, at the end of the service life, it shall be reimbursed with the then value of the original investment, or with funds sufficient to replace the plant. As will be shown presently, there is no basis for assuming that either the value of the original investment or the replacement cost will, at the end of the service life, equal or approximate the present value. See note 49, *infra*.

[13]"Depreciation of physical units used in connection with public utilities, or indeed, with any other industries, does not proceed in accordance with any mathematical law. . . . There is no regularity in the development of the increasing need for repairs; there is no regularity in the progress of depreciation; but, in order to devise a reasonable plan for laying aside allowances from year to year to make good the depreciation as it accrues, and to provide for the accumulation of a sum equivalent to the cost less salvage of a unit by the time it is retired, some theory of depreciation progress must be assumed on which such allowances may be based." 81 Am. Soc. of Civil Eng. Transactions (1917), 1311, 1462, 3. Compare E. A. Saliers, *op. cit.*, note 11.

[14]"In our valuation work they (the railroad companies) have consistently taken the position that no depreciation exists in a railroad property which is maintained in 100 per cent efficiency." Proposed Report of Interstate Commerce Commission on Telephone and Railroad Depreciation Charges, Docket Nos. 14700 and 15100, August 15, 1929, p. 20.

to the total net expense of its retirement.[15] To that end it is necessary only that some reasonable plan of distribution be adopted. Since it is impossible to ascertain what percentage of the service life is consumed in any year,[16] it is either assumed that depreciation proceeds at some average rate (thus accepting the approximation to fact customarily obtained through the process of averaging) or the annual charge is fixed without any regard to the rate of depreciation.

The depreciation charge is an allowance made pursuant to a plan of distribution of the total net expense of plant retirement. It is a bookkeeping device introduced in the exercise of practical judgment to serve three purposes. It preserves the integrity of the investment. Compare Knoxville v. Knoxville Water Co. (1909) 212 U. S. 1, 13, 14, 53 L. ed. 371, 29 Sup. Ct. Rep. 148. It serves to distribute equity throughout the several years of service life the only expense of plant retirement which is capable of reasonable ascertainment —the known cost less the estimated salvage value. And it enables those interested, through applying that plan of distribution, to ascertain, as nearly as is possible, the actual financial results of the year's operation. Many methods of calculating the amount of the allowance are used.[17] The charges to operating expenses in the several years and in the aggregate vary according to the method adopted.[18] But under none of these methods of fixing the depreciation charge is an attempt made to determine the percentage of actual consumption of plant falling within a particular year or within any period of years less than the service life.[19]

Third. The business device known as the depreciation charge appears not to have been widely adopted in America until after the beginning of this century.[20] Its use is still stoutly resisted by many concerns.[21] Wherever

[15]Some contend "that where accruing depreciation is dependent, not upon lapse of time, but upon amount and extent of use, it is unscientific to provide for depreciation charges in equal annual instalments, and that these charges should be made to correspond with units of use rather than of time. By relating the charges to units of use, they contend that the burden of the charges will be spread more equitably, to the financial advantage of the carrier, over alternating periods of light and heavy traffic." Proposed Report of the Interstate Commerce Commission, note 14, *supra*, p. 15. The practices of street railways differ in respect to the manner of laying the year's contribution to the depreciation reserve. Some lay a fixed percentage upon the gross revenues; some a number of cents per car mile; some a fixed percentage on the cost of the depreciable plant. Though expressed in different terms, the amount contemplated to be charged may in fact be based on cost. See, e. g., Re Elizabethtown Water Co. (1927) P.U.R. 1927E, 39.

[16]See testimony on rehearing of Telephone and Railroad Depreciation Charges, note 10, *supra*, A. B. Crunden, March 21, 1928 (Printed by American Tel. & Tel. Co.), pp. 108-9; Dr. M. R. Maltbie, June 27, 1928, transcript, p. 1396.

[17]See note 56, *infra*.

[18]See note 55, *infra*.

[19]See E. A. Saliers, *op. cit.*, note 11, supra, at p. 132: "This method (reducing balance), . . . does not take into account either the actual rapidity with which depreciation occurs, or the various modifying factors which may show their influence at any time. Since this objection is common to all methods, other considerations will probably lead to a choice."

[20]The first case in which this court expressly recognized a depreciation allowance as a part of operating expenses is Knoxville v. Knoxville Water Co. 212 U. S. 1, 13, 53 L. ed. 371, 29 Sup. Ct. Rep. 148, decided in 1909. In earlier cases cognizance was not taken of it. Compare Union P. R. Co. v. United States (1879) 99 U. S. 402, 420, 25 L. ed. 274; United States v. Kansas P. R. Co. (1879) 99 U. S. 455, 459, 25 L. ed. 289; San Diego Land & Town Co. v. Jasper (1903) 189 U. S. 439, 446, 47 L. ed. 892, 23 Sup. Ct.

adopted, the depreciation charge is based on the original cost of the plant to the owner. When the great changes in price levels incident to the World War led some to question the wisdom of the practice of basing the charge on original cost, the Chamber of Commerce of the United States warned business men against the fallacy of departing from the accepted basis.[22] And that warning has been recently repeated: "When the cost of an asset, less any salvage value, has been recovered, the process of depreciation stops,—the consumer has paid for that particular item of service. There are those who maintain that the obligation of the consumer is one rather of replacement,—building for building, machine for machine. According to this view depreciation should be based on replacement cost rather than actual cost. The replacement theory substitutes for something certain and definite, the actual cost, a cost of reproduction which is highly speculative and conjectural and requiring frequent revision. It, moreover, seeks to establish for one expense a basis of computation fundamentally different from that used for the other expenses of doing business. Insurance is charged on a basis of actual premiums paid, not on the basis of probable premiums three years hence; rent on the amount actually paid, not on the problematical rate of the next lease, salaries, light, heat, power, supplies are all charged at actual, not upon a future contingent cost. As one writer has expressed it, 'The fact that the plant cannot be replaced at the same cost, but only at much more, has nothing to do with the cost of its product, but only with the cost of future product turned out by the subsequent plant.' As the product goes through your factory it should be burdened with expired, not anticipated, costs. *Charge depreciation upon actual cost less any salvage.*"[23]

Such is today, and ever has been, the practice of public accountants.[24] Their statements are prepared in ac-

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Rep. 571. See also Lincoln Gas & E. L. Co. v. Lincoln (1912) 223 U. S. 349, 363, 56 L. ed. 466, 32 Sup. Ct. Rep. 271. Among street railways, the Milwaukee Electric Railway & Light Company became the pioneer by adopting it in 1897. Others followed in 1905. 31 Street Ry. Journal 169, 70; 687, 8. In England, the adoption of the depreciation charge had been hastened by a provision in the income tax law. Customs and Inland Revenue Act 1878, 41 Vict. c. 15, § 12. Massachusetts Acts 1849, c. 191, provided that the annual report required of railroads should give full information on "Estimated depreciation beyond the renewals, viz: road and bridges, buildings, engines, and cars." See also Act 1846, c. 251. But in Massachusetts, as elsewhere in the United States, depreciation charges have not been customary among railroads, except in respect to equipment, pursuant to the rule prescribed by the Interstate Commerce Commission in 1907.

[21]See Telephone and Railroad Depreciation Charges (1926) 118 Inters. Com. Rep. 295, 301-303; Proposed Report of August 15, 1929, note 14, *supra*, pp. 5–12, 17–20; H. E. Riggs, Depreciation of Public Utility Properties (1922) 78-92.

[22]See a pamphlet "Depreciation" issued on October 15, 1921, by the Fabricated Productions Department (now the Department of Manufacture) of the Chamber of Commerce of the United States.

[23]See pamphlet "Depreciation, Treatment in Production Costs," issued by Department of Manufacture, Chamber of Commerce of the United States, No. 512 (May, 1929), p. 7. In the Foreword it is said: "In presenting this treatise on depreciation, we have drawn not only on our own resources, but also have had the co-operation of many manufacturers, industrial engineers, and accountants."

[24](1904) H. L. C. Hall, Manufacturing Costs, 132; (1905) B. C. Bean, Cost of Production, 75-98; (1911) H. A. Evans, Cost Keeping and Scientific Management, 30-5; S. Walton and S. W. Gilman, Auditing and Cost Accounts (11 Modern Business) 63-70; F. E. Webner, Factory Costs, 171; (1913) R. H. Montgomery, Auditing Theory and Prac-

cordance with principles of accounting which are well established, generally accepted and uniformly applied. By those accustomed to read the language of accounting a depreciation charge is understood as meaning the appropriate contribution for that year to the amount required to make good the cost of the plant which ultimately must be retired. On that basis, public accountants certify to investors and bankers the results of operation, whether of public utilities, or manufacturing or mercantile concerns. Corporate securities are issued, bought, and sold, and vast loans are made daily, in reliance upon statements so prepared. The compelling logic of facts which led business men to introduce a depreciation charge has led them to continue to base it on the original cost of the plant despite the great changes in the price level incident to the World War. Basing the depreciation charge on cost is a rule prescribed or recommended by those associations of business men who have had occasion since the World War to consider the subject.[25]

Business men naturally took the

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tice, 317-39, (1921 ed.) Vol. 1, p. 634; (1915) F. H. Baugh, Principles and Practice of Cost Accounting, 42, 46-51; (1916) C. H. Scovell, Cost Accounting and Burden Application, 81-9; (1918) H. C. Adams, American Railway Accounting, 99-100, 279; R. B. Kester, Accounting Theory and Practice, Vol. 2, 99-209, 202; (1920) I. A. Berndt, Costs, Their Compilation and Use in Management, 101-6; Hodge and McKinsey, Principles of Accounting, 74-5; J. F. Sherwood, Public Accounting and Auditing, Vol. 1, 145-54; (1921) DeW. C. Eggleston and F. B. Robinson, Business Costs, 294-304; G. S. Armstrong, Essentials of Industrial Costing, 169-79; D. E. Burchell, Industrial Accounting, Series 1, No. 3, I, A. 2d(3); (1922) G. E. Bennett, Advanced Accounting, 212-34, 219; (1923) P. M. Atkins, Industrial Cost Accounting for Executives, 119-22; E. J. Borton, Cost Accounting Principles and Methods, 82-3; (1924) J. H. Bliss, Management Through Accounts, 304-14; W. H. Bell, Auditing, 232-40; H. P. Cobb, Shoe Factory Accounting and Cost Keeping, 232-40; C. B. Couchman, The Balance Sheet, 22-3; 49-56, 201-3; J. L. Dohr, Cost Accounting Theory and Practice, 378-87; 380; F. W. Kilduff, Auditing and Accounting Handbook, 380; E. L. Kohler and P. W. Pettengill, Principles of Auditing, 112-14; W. B. Lawrence, Cost Accounting, 308-10; A. B. Manning, Elements of Cost Accounting, 80; C. H. Scovell, Interest As A Cost, 83-4; F. E. Webner, Factory Overhead, 227; (1925) D. F. Morland and R. W. McKee, Accounting for the Petroleum Industry, 43-53; (1926) R. E. Belt, Foundry Cost Accounting, 240-3; DeW. Eggleston, Auditing Procedure, 319-20; (1927) S. Bell, Practical Accounting, 130-43; T. A. Budd and E. N. Wright, The Interpretation of Accounts, 195, 251-63, 253; H. R. Hatfield, Accounting, 145-6; (1928) C. R. Boland, Shoe Industry Accounting, 158-9; H. E. Gregory, Accounting Reports in Business Management, 158, 164-6; W. H. Hemingway, The National Financial Statement Interpreter, § 12, pp. 13-20; G. A. Prochazka, Accounting and Cost Finding for the Chemical Industries, 206-11; (1929) A. H. Church, Manufacturing Costs and Accounts, 5, 205ff; R. H. Montgomery, Auditing (Revision by W. J. Graham), 116-9; T. H. Sanders, Industrial Accounting, 144-5. See E. A. Saliers, Depreciation, Principles and Applications (1923) 56, 410, 425. At the Fourth International Cost Conference of the National Association of Cost Accountants held in Buffalo, N. Y., Sept. 10–13, 1923, the question whether depreciation charges should be based on original cost or replacement value was debated. On a vote at the close of the debate "nearly all rose" in favor of original cost. N. A. C. C. Yearbook 1923, pp. 183-201 at 201. The rule is the same in England. E. W. Newman, The Theory and Practice of Costing (1921) 20.

[25]National Coal Association, Annual Meeting at Chicago, May 21-23, 1919, Report and Suggestions of Committee on Standard System of Accounting and Analysis of Costs of Production, see also W. B. Reed, Bituminous Coal Mine Accounting, 1922, p. 119-126; Midland Club (Manufacturing Confectioners, Chicago) Official Cost Accounting and Cost Finding Plan, 1919, p. 43; United Typothetae of America: Standard Cost Finding System, pp. 4, 7, Treatise On The Practical Accounting System for Printers, 1921, p. 15, The Standard Book on Cost Finding by E. J. Koch, published by U. T. of A., pp. 13-14, Treatise on the Standard Accounting System for Printers, Interlocking With the Standard Cost Finding System, 1920, pp. 44-45; Tanners' Council: Uniform Cost Accounting System for the Harness Leather Division of the Tanning Industry, officially adopted Dec.

plant at cost, as that is how they treat other articles consumed in operation. The plant, undepreciated, is commonly carried on the books at cost; and and it is retired at cost. The net profit or loss of a business transaction is commonly ascertained by deducting from the gross receipts the expenditures incurred in producing them. Business men realized fully that the requirements for replacement might be more or less than the original cost. But they realized also that to attempt to make the depreciation account reflect economic conditions and changes would entail entry upon new fields of conjecture and prophecy which would defeat its purposes. For there is no basis in experience which can justify predicting whether a replacement, renewal, or substitution falling in some future year will cost more or less than it would at present, or more or less than the unit cost when it was acquired.

The business men's practice of using a depreciation charge based on the original cost of the plant in determining the profits or losses of a particular year has abundant official sanction and encouragement. The practice was prescribed by the Interstate Commerce Commission in 1907,[36] when, in co-operation with the Association of American Railway Accounting Officers, it drafted the rule, which is still in force,[37] requiring steam railroads to make an annual depreciation charge on equipment. It has been consistently applied by the Federal Government in assessing taxes on net income and corporate profits;[38] and

1, 1921, p. 31, Uniform Cost Accounting System for the Sole and Belting Leather Division of the Tanning Industry, 1921, p. 31, Uniform Cost Accounting System for the Calf, Kip, and Side Upper; Glove, Bag, and Strap; and Patent Leather Divisions of the Tanning Industry, 1922, pp. 35, 48, Uniform Cost Accounting System for the Goat and Cabretta Leather Division of the Tanning Industry, 1922, p. 27; National Retail Coal Merchants Association, Complete Uniform Accounting System for Retail Coal Merchants, 1922, Account A-120, p. 6; The Associated Knit Underwear Manufacturers of America, Cost Control for Knit Underwear Factories, 1924, p. 52; National Knitted Outerwear Association, Inc., Cost Accounting Manual for the Knitted Outerwear Industry (by W. Lutz), 1924, pp. 18–20; American Drop Forging Institute, Cost Committee, Essentials of Drop Forging Accounting, 1924, pp. 36-7; Rubber Association of America, Inc., Manual of Accounts and Budgetary Control for the Rubber Industry, by the Accounting Committee, 1926, pp. 70, 71, 75, 79, 82; Packing House Accounting, by Committee on Accounting of the Institute of American Meat Packers, 1929, p. 325; Cost Accounting for Throwsters, issued by Commission Throwsters' Division of The Silk Association of America, Inc., 1928, pp. 29-30; Cost Accounting for Broad Silk Weavers, issued by The Broad Silk Division of The Silk Association of America, Inc., 1929, pp. 44-45. As there stated: "The use of replacement cost as a basis for depreciation charges has been eliminated due to the following reasons: 1. Depreciation is charged to manuafcturing cost to absorb the reduction in value of capital assets through the effect of use and time. It does not represent an accumulation for the purpose of acquiring assets in the future. 2. The replacement cost theory is impractical because it would require a constant revaluation of assets. It is, furthermore, unlikely that any manufacturer would rebuild the same plant ten years after its construction. 3. The depreciation charge absorbed in the cost of the product represents a charge for the use of present manufacturing facilities and cannot have any connection with assets to be acquired in the future. The depreciation charge on new and more efficient equipment to be acquired in the future may be higher and, perhaps, offset by a general reduction in manufacturing cost per unit. It is not logical to base all other cost elements on present expenses and make the one exception in the case of depreciation." (p. 45.)

[36] Classification of Operating Expenses as Prescribed by the Interstate Commerce Commission, Third Revised Issue 1907, pp. 10-12, 38, 44-51.

[37] Classification of Operating Revenues and Operating Expenses of Steam Roads Prescribed by the Interstate Commerce Commission, Issue of 1914, pp. 59, 61-8. Cf. Special Instructions 8, *Id.* p. 33.

[38] Act of Oct. 3, 1913, ch. 16, § II, B, 38

by the tax officials of the several States for determining the net profits or income of individuals and corporations.[29] Since 1911, it has been applied by the United States Bureau of the Census.[30] Since 1915, it has been recommended by the Department of Agriculture.[31] Since 1917 by the Bureau of Mines.[32] In 1916, it was adopted by the Federal Trade Commission in recommendations concerning depreciation issued to manufacturers.[33] In 1917, it was prescribed by the United States Fuel Administration,[34] and by the War Ordnance Department.[35] In 1918, by the Air Craft Production Board.[36] In 1921, it was prescribed by the Federal Power Commission;[37] and it is continued in the revised rules of 1928.[38] In 1923, it was adopted by the depreciation section of the Interstate Commerce Commission in the report of tentative conclusions concerning depreciation charges submitted to the steam railroads, telephone companies, and car-

Stat. 114, 167, United States Internal Revenue Regulations No. 33, Jan. 5, 1914, Art. 129-146, p. 69-73; Act of Sept. 8, 1916, ch. 463, § 5(a), and 6(a), 39 Stat. 756, 759, 760, Regulations No. 33 (Revised 1918), Art. 159-165, pp. 80-82; Act of Feb. 24, 1919 (Revenue Act of 1918), ch. 18, § 214(a), par. (8) & (10), § 234 (a), par. (7) and (9), 40 Stat. 1057, 1067-8, 1078, Regulations 45, Art. 161-171, pp. 62-66; Act of Nov. 23, 1921, ch. 136, § 214(a), par. (8) & (10), and § 234(a), par. (7) & (9), 42 Stat. 227, 240, 241, 255, 256, Regulations 62, Art. 161-171, pp. 74-78; Act of June 2, 1924, ch. 234, § 214(a), par. (8) & (9) and § 234(a) par. (7) & (8), 43 Stat. 253, 270-1, 284-5, Regulations 65, Art. 161-171, pp. 54-58; Act of Feb. 26, 1926, ch. 27, § 214(a), par. (8) & (9) and § 234(a), par. (7) & (8); 44 Stat. (Part 2), 9, 27, 42-3, Regulations 69, Art. 161-170, pp. 56-60; Act of May 29, 1928, ch. 852, § 23, par. (k) & (l), §§ 113 & 114, 45 Stat. 791, 800, 818, 821, Regulations 74, Art. 201-210, pp. 51-56. See also Bureau of Internal Revenue, Bulletin "F," Income Tax, Depreciation and Obsolescence (1920) 18; Outline For The Study of Depreciation and Maintenance, prepared by the Bureau of Internal Revenue (1926).

[29]N. L. McLaren & V. K. Butler, California Tax Laws of 1929, 117ff; Prentice-Hall Massachusetts State Tax Service (Personal) 1926-28 paragraphs 13875-7, p. 13559; Mississippi Income Tax Law of 1924, (Issued by State Tax Commission), § 12(a) (8), Regulations No. 1 (1925), Art. 136-8, pp. 52-3; New York State Tax Commission Income Tax Bureau, Manual 22 (1922), Art. 171-6, p. 35-6, Manual 25 (1925), Art. 171-6, pp. 33-4, C. C. H. 1928-29, Personal Income Tax, par. 4511, p. 2793; G. R. Harper, A Digest of the Oregon State Income Tax Act and Regulations (1924), 18; Wisconsin Tax Service (Henry B. Nelson, Inc.), 1929, Vol. I, pp. 163-4.

[30]Uniform Accounts for Systems of Water Supply, arranged by the U. S. Bureau of the Census, American Water Works Association and Others (1911) 27.

[31]U. S. Department of Agriculture, Bulletin 178, March 1, 1915, Cooperative Organization Business Methods, pp. 13-14; Bulletin 236, May 1, 1915, A System of Accounts for Farmers' Cooperative Elevators, p. 16; Bulletin 225, May 7, 1915, A System of Accounting for Cooperative Fruit Associations, p. 20; Bulletin 362, May 6, 1916, A System of Accounts for Primary Grain Elevators, p. 17; Bulletin 590, Feb. 27, 1918, A System of Accounting for Fruit Shipping Organizations, p. 23; Bulletin 985, A System of Accounting for Cotton Ginneries, 23, 27.

[32]Department of the Interior, Bureau of Mines, Bulletin 158, Petroleum Technology 43, Cost Accounting for Oil Producers, 1917, pp. 111-112; Technical Paper 250, Metal Mine Accounting, 1920, p. 26.

[33]Federal Trade Commission, Fundamentals of a Cost System for Manufacturers, July 1, 1926, pp. 12, 13.

[34]U. S. Fuel Administration, A System of Accounts for Retail Coal Dealers, Nov. 1, 1917, p. 17.

[35]War Department, Office of The Chief of Ordnance, Form 2941, Definition of "Cost" Pertaining to Contracts, June 27, 1917, pp. 9-11.

[36]Bureau of Air-Craft Production, General Ruling No. 28, May 3, 1918, of the Rulings Board of the Finance Department to the effect that in cost plus contracts depreciation must be based on original cost and "In no case shall depreciation be based on the cost of reproduction at present prices." See E. A. Saliers, *op. cit.*, note 11.

[37]Rules and Regulations Governing the Administration of the Federal Water Power Act (1921), Regulation 16.

[38]Rules and Regulations Governing the Administration of the Federal Water Power Act (1928), Regulation 16, pp. 31-36.

riers by water,[39] pursuant to paragraph 5 of § 20, of the Interstate Commerce Act, as amended by Transportation act 1920.[40] On November 2, 1926, it was prescribed by the Commission in Telephone and Railroad Depreciation Charges (1926) 118 Inters. Com. Rep. 295. A depreciation charge based on original cost has been uniformly applied by the Public Utility Commissions of the several states when determining net income, past or expected, for rate-making purposes.[41]

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[39]Bureau of Accounts, Depreciation Section, Report of the Preliminary Investigation of Depreciation Charges in Connection with Steam Roads and the Tentative Conclusions and Recommendations of the Depreciation Section for the Regulation of Such Charges, Docket No. 15100, Aug. 23, 1923, pp. 11–13; Same for Telephone Companies, Docket No. 14700, March 10, 1923, pp. 6, 18-21.

[40]Act of Feb. 28, 1920, ch. 91, 41 Stat. 456, 493.

[41]*Illinois*—Re Middle States Teleph. Co. (1928) P.U.R.1929B, 390, 396; Re Dixon Water Co. (1928) P.U.R.1929B, 403, 408; Re Vermont Teleph. & Exch. Co. (1928) P.U.R. 1929B, 411, 415; Re East St. Louis & Interurban Water Co. (1927) P.U.R.1928A, 57, 68; Re Pekin Water Works Co. (1927) P.U.R.1928C, 266, 276; Re Kinloch-Bloomington Teleph. Co. (1927) P.U.R.1927E, 135, 142; *Indiana*—Re Home Teleph. Co. (1927) P.U.R.1928A, 445, 455; Re Logansport Home Teleph. Co. (1928) 1928E, 714, 725; Re Butler Teleph. Co. (1924) P.U.R.1925A, 240, 242, (1927) P.U.R.1927C, 800, 804; *Minnesota*—Re Duluth Street R. Co. (1926) P.U.R. 1927A, 41, 52, 55; *Missouri*—Re Capital City Water Co. (1928) P.U.R.1928C, 436, 460, 1; Re Clinton County Teleph. Co. (1927) P.U.R.1928B, 796, 807; Re Capital City Water Co. (1925) P.U.R.1925D, 41, 56, 57; *Nebraska*—Re Platte Valley Teleph. Corp. (1927) P.U.R.1928C, 193, 200; Re Meadow Grove Teleph. Co. (1928) 1928D, 472, 477; Re Madison Teleph. Co. (1928) P.U.R. 1929B, 385, 389; *New Jersey*—Re Elizabethtown Water Co. (1927) P.U.R.1927E, 39, 63; Re Coast Gas Co. (1922) P.U.R.1923A, 349, 366; *New York*—Baird v. Burleson (1920) P.U.R.1920D, 529, 538; *Utah*—Re Big Spring Electric Co. (1926) P.U.R.1927A, 655, 665-7; *Wisconsin*—Re Wisconsin-Minnesota Light & P. Co. (1920) P.U.R.1920D, 428, 433-5; Milwaukee Electric R. & Light Co. v. Milwaukee (1918) P.U.R.1918E, 1, 58; but see Re Wisconsin Teleph. Co. (1927) P.U.R. 1928B, 434; *West Virginia*—Re Cumberland & Allegheny Gas Co. (1927) P.U.R.1928B, 20, 80; Re Clarksburg Light & Heat Co. (1927) P.U.R.1928B, 290, 322-325; Re Pittsburgh & West Virginia Gas Co. (1927) P.U.R.1927D, 844, 851; *South Carolina*—Re Rock Hill Teleph. Co. (1928) P.U.R.1928E, 221, 230: "We are of opinion that the cost of the property is the only possible reasonable authority upon which depreciation can be calculated. Depreciation is a reserve to equalize retirements and not a reserve to equalize replacements. A rate of depreciation based upon original cast, even, is little more than an intelligent guess; but based upon reproduction costs is the blindest kind of speculation. With the known original cost of a unit and an engineer's estimate of its service life and salvage value, . . . some semblance of accuracy might be reached. To guess its service life and salvage value is bad enough but who would venture to guess what it would cost to reproduce it ten or twenty years thereafter. . . . Depreciation reserve is intended to keep the investment level but not to insure the hazards of varying future."

In its second report in the instant case the Commission said: "The plan of providing for retirements at cost is that followed by the Interstate Commerce Commission and the utility regulatory Commissions of most of the states, and by all other utilities under the jurisdiction of this Commission." P.U.R. 1929A, 180, 181.

The cost basis is required in the following classifications of accounts prescribed by the Commissions of: *Colorado*—Uniform System of Accounts for electric light and power utilities, 1915, account No. 351, pp. 29, 30, account No. 775, pp. 67, 68. Uniform System of Accounts for gas utilities, 1916, account No. 351, p. 28, account No. 775, pp. 56, 57; Uniform System of Accounts for water utilities, 1920, account No. 351, pp. 25, 26, account No. 775, pp. 65, 66; *California*—Uniform Classification of Accounts for telephone companies, 1913, pp. 54, 55; for water corporations, 1919, pp. 14, 15, account No. 29; for gas corporations, 1915, account No. 29, p. 15; for electric corporations, 1919, account No. 29, p. 15; *Connecticut*—Uniform System of Accounts for water companies, 1922, account No. 180, p. 17; *Georgia*—Uniform System of Accounts for telephone companies, 1920, pp. 6, 7, account No. 12, p. 12, account No. 19, p. 16; *Idaho*—Uniform System of Accounts for water corporations, 1914, account 402, pp. 92, 93; account W6, p. 10; for electric light and power companies, 1914, account 54, p. 29, account 215, p. 95; *Indiana*—Uniform System of Accounts for water utilities, 1920, account 370, p. 52,

Fourth. In 1927 the business men's practice of basing the depreciation charge on cost was applied by this court in United States v. Ludey (1927) 274 U. S. 295, 300–301, 71 L. ed. 1054, 47 Sup. Ct. Rep. 608, a Federal income tax case, saying: "The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost."[42] I know of nothing in the Federal Constitution, or in the decisions of this Court, which should lead us to reject, in determining net profits, the rule sanctioned by the universal practice of business men and governmental departments. For, whether the expense in plant consumption can be more nearly approximated by using a depreciation charge based on original cost or by one based upon fluctuating present values is a problem to be solved, not by legal reasoning, but by the exercise of practical judgment based on facts and business experience. The practice of using an annual depreciation charge based on original cost[43] when determining for purposes of investment, taxation, or regulation, the net profits of a business, or the return upon property, was not adopted in ignorance of the rule of Smyth v. Ames, 169 U. S. 466, 42 L. ed. 819, 18 Sup. Ct. Rep. 418. That decision, rendered in 1898, antedates the general employment of public accountants;[44] and also antedates the general introduction here of the practice of making a depreciation charge. The decision of the court of appeals of Maryland here under review, as well as State ex rel. Hopkins v. Southwestern Bell Teleph. Co., 115 Kan.

account 335, p. 82; for electric utilities, 1920, account 297, p. 73, account 309, p. 46; for heating utilities, 1920, account 22, p. 18, and account 118, p. 35; for electric railways, 1913, pp. 52, 53; *Kansas*—Uniform System of Accounts for class D telephone companies, 1920, p. 4; *Massachusetts*—Uniform System of Accounts for gas and electric companies, 1921, account G678, p. 96, E678, p. 118, also pp. 27, 28; *Minnesota*—Uniform System of Accounts for telephone companies class C and D, 1918, accounting circular No. 52, account 360, pp. 24, 25; *Missouri*—Uniform System of Accounts for class D telephone corporations, Public Service Commission General Order No. 22, 1918, pp. 9, 10; *Montana*—Uniform Classification of Accounts for gas utilities, 1913, pp. 20, 21, 35; for electric utilities (undated but after 1919), pp. 25, 42, 43; for telephone utilities, 1913, pp. 22, 35; for water utilities (undated but after 1919), 26, 42; for street railways, 1913, 26, 41; *New Hampshire*—Uniform Classification of Accounts for gas utilities, Accounting Circular No. 2, 1914, account 220, p. 88, account 98, pp. 53, 54; *New Jersey*—Uniform System of Accounts for electric light, heat and power utilities, 1915, account 215, pp. 26, 27, account 494, p. 77; for street or traction railway utilities, 1919, p. 18 (the accounts here are called "Accrued Amortization of Capital" and "General Amortization" instead of "Depreciation Reserve" and "Depreciation Account" or "Expense"); *Pennsylvania*—Uniform Classification of Accounts for common carriers by motor vehicle, Class A, 1928, account 179, pp. 31, 32; class B, 1928, account 179, p. 26; class C, 1928, p. 20. No information has been found about the practice in the states not listed.

[42] The Railways must hereafter assume the anomalous position of classing the additional $755,116 as an operating expense in its report to the Commission, and as part of its net income, in its income tax returns.

[43] When original cost is not known, or when property is acquired in some unusual way not involving purchase, some other base must, of course, be taken. But it is always a stable one. Original cost, as used in this opinion includes other such stable bases. Compare Revenue Act of 1928, Act of May 29, 1928, ch. 852, § 113, 45 Stat. 791, 818; Interstate Commerce Commission rules cited in notes 26 and 27, *supra*.

[44] The first American statute providing for examination of accountants and the use of the title C. P. A. was enacted by New York in 1896. Accountants' Handbook, edited by E. A. Saliers, p. 1326.

236, P.U.R.1924D, 388, 223 Pac. 771[45] and Michigan Pub. Utilities Commission v. Michigan State Teleph. Co. (1924) 228 Mich. 658, P.U.R.1925C, 158, 200 N. W. 749,[46] were all decided after this court reaffirmed the rule of Smyth v. Ames, *supra*, in Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Service Commission (1923) 262 U. S. 276, 67 L. ed. 981, P.U.R.1923C, 193, 43 Sup. Ct. Rep. 544, 31 A.L.R. 807. But since this decision, as before, the Bell Telephone companies have persisted in basing their depreciation charges upon the original cost of the depreciable property, Public Utility Comrs. v. New York Teleph. Co. (1926) 271 U. S. 23, 27, 70 L. ed. 808, P.U.R.1926C, 740, 46 Sup. Ct. Rep. 363. And they have insisted that the order of the Interstate Commerce Commission requiring a depreciation charge, 118 Inters. Com. Rep. 295, should be so framed as to permit the continuance of that accounting practice.[47] The protest of the railroads, in that proceeding, against basing the charge on cost was made for the first time in 1927, in their petitions for a rehearing. And this protest came only from those who insist that no depreciation charge whatsoever shall be made.[48]

To use a depreciation charge as the measure of the year's consumption of plant, and at the same time reject original cost as the basis of the charge, is inadmissible. It is a perversion of this business device. No method for the ascertainment of the amount of the charge yet invented is workable if fluctuating present values be taken as the basis. Every known method contemplates, and is dependent upon, the accumulation or credit of a fixed amount in a given number of years. The distribution of plant expense expressed in the depreciation charge is justified by the approximation to the fact as to the year's plant consumption which is obtained by applying the doctrine of averages. But if fluctuating present values are substituted for original cost there is no stable base to

[45] In that case, the Special Commissioner to whom the case was referred, stated in his opinion (printed as an Appendix to the opinion of the supreme court, pp. 271–322, at p. 292), that if the return is figured on the present value of the utility's property, then the depreciation allowance must also be so figured. The supreme court did not mention this question in its opinion.

[46] The Michigan Supreme Court made a statement similar to that of the Special Commissioner in the Kansas Case, *supra*, but did not disturb the finding of the Commission. The court made no reference to the insurmountable practical difficulties presented.

[47] Telephone and Railroad Depreciation Charges (1926) 118 Inters. Com. Rep. 295, 301; testimony on behalf of the Bell System Companies, upon rehearing, March 19, 20, 21, 1928 (printed by American Tel. & Tel. Co.), pp. 6, 11–13, 98. See their brief submitted on original argument, p. 48: "The amount of the depreciation expense is the cost of the property used up; that is, it is the dollars consumed. Therefore, it is the cost less the salvage realized at retirement." Also original record, May 1, 1923, pp. 12, 13, 20; Proposed Report of August 15, 1929, p. 14; Preliminary Report of Depreciation Section, Docket No. 14700, note 39, *supra*, pp. 6, 7.

[48] In Telephone and Railroad Depreciation Charges (1926) 118 Inters. Com. Rep. 295, 344, the Commission said: "It is agreed by all that depreciation expense should be based primarily upon the original cost to the accounting company of the unit of property in question." In the petition for rehearing filed by the Presidents' Conference Committee on Valuation, however, it was stated, p. 15: "Consideration should be given to the question of whether accounting depreciation, as the order conceives it, should be estimated upon the basis of original cost or of present value, . . ." A similar statement is made for the first time in the petition for rehearing filed by the New York Central lines, at p. 5.

which the process of averaging can be applied. For thereby the only stable factor involved in fixing a depreciation charge would be eliminated. Each year the present value may be different. The cost of replacement at the termination of the service life of the several units or of the composite life cannot be foretold.[49] To use as a measure of the year's consumption of plant a depreciation charge based on fluctuating present values substitutes conjecture for experience. Such a system would require the consumer of today to pay for an assumed operating expense which has never been incurred and which may never arise.

The depreciation charge is frequently likened to the annual premium in legal reserve life insurance. The life insurance premium is calculated on an agreed value of the human life —comparable to the known cost of plant—not on a fluctuating value, unknown and unknowable. The field of life insurance presented a problem comparable to that here involved. Despite the large experience embodied in the standard mortality tables and the relative simplicity of the problem there presented, the actual mortality was found to vary so widely from that for which the premiums had provided, that their rate was found to work serious injustice either to the insurer or to the insured. The transaction resulted sometimes in bankruptcy of the insurer; sometimes in his securing profits which were extortionate; and rarely, in his receiving only the intended fair compensation for the service rendered. Because every attempt to approximate more nearly the amount of premium required proved futile, justice was sought and found in the system of strictly mutual insurance. Under that system the premium charged is made clearly ample; and the part which proves not to have been needed enures in some form of benefit to him who paid it.

Similarly, if, instead of applying the rule of Smyth v. Ames (1898) 169 U. S. 466, 42 L. ed. 819, 18 Sup. Ct. Rep. 418, the rate base of a utility were fixed at the amount prudently invested, the inevitable errors incident to estimating service life and net expense in plant consumption could never result in injustice either to the utility or to the community. For, if the amount set aside for depreciation proved inadequate and investment of new capital became necessary, the utility would be permitted to earn a return on the new capital. And if the amount set aside for depreciation proved to be excessive, the income from the surplus reserve would operate as a credit to reduce the capital charge which the rates must earn. If the Railways should ever suffer in-

[49] In part, costs and values in the several future years will depend upon the general price level. As to this, even the economist can know nothing, save how the general price level has heretofore fluctuated from year to year; and that periods of rising prices have ever been followed by periods of falling prices. But cost and value in the several future years will depend in part upon factors other than the general price level. Even if the general price level for every future year were known, it would still be impossible to predict with reasonable accuracy the then cost or value of a unit then to be replaced, renewed or retired. For despite a higher general price level, the part might be procurable at smaller costs, by reason of economics introduced in its manufacture and changes in the methods and means of performing the work. See Excess Income of St. Louis & O'Fallon R. Co. (1927) 124 Inters. Com. Rep. 3, 29, 41.

justice from adopting cost of plant as the basis for calculating the depreciation charge, it will be an unavoidable incident of applying in valuation the rule of Smyth v. Ames, *supra*. This risk, if it exists, cannot be escaped by basing the charge on present value. For this suggested escape, besides being entirely conjectural, is instinct with certainty of injustice either to the community or the Railways. The possibility of such injustice admonishes us, as it did indeciding the constitutional questions concerning interstate commerce, Foster-Fountain Packing Co. v. Haydel (1928) 278 U. S. 1, 10, 73 L. ed. 147, 49 Sup. Ct. Rep. 1; Federal Trade Commission v. Pacific States Paper Trade Asso. (1927) 273 U. S. 52, 64, 71 L. ed. 534, 47 Sup. Ct. Rep. 255; and taxation, Mountain Timber Co. v. Washington (1917) 243 U. S. 219, 237, 61 L. ed. 685, 37 Sup. Ct. Rep. 260; Shaffer v. Carter (1920) 252 U. S. 37, 55, 64 L. ed. 445, 40 Sup. Ct. Rep. 221; Farmers Loan & Trust Co. v. Minnesota, No. 26, p. 4, decided this day, that rate regulation is an intensely practical matter.

Fifth. Public officials, investors and most large businesses are convinced of the practical value of the depreciation charge as a guide to knowledge of the results of operation. Many states require public utilities to make such a charge.[50] But most railroads some gas and electric companies, and some other concerns deny the propriety of making any annual depreciation charge.[51] They insist that the making of such a charge will serve rather to mislead than to aid in determining the financial result of the year's operations. They urge that the current cost of maintaining the plant, whether by repair, renewals, or replacements, should be treated as a part of the maintenance account, at least in systems consisting of large and diversified properties intended for continuous operation and requiring a constant level of efficiency. They insist that, in such systems, retirements, replacements, and renewals attain a uniform rate and tend to be equal

[50] *Alabama*—Code of 1928, § 9769, p. 1758; *Arizona*—Revised Stat. 1913 (Civil Code), Tit. 9, § 2325, p. 807; *California*—Deering, Gen. Laws, 1923, Vol. 2, Act 6386, § 49, p. 2721; *Colorado*—Comp. L. 1921, § 2945, p. 2928; *Idaho*—Comp. Stat. 1919, Vol. 1, § 2473, p. 703; *Illinois*—Cahill's Rev. Stat. 1929, ch. 111a, § 29, p. 2045; *Indiana*—Burns Ann. Stat. 1926, Vol. 3, § 12693-12696, p. 1245; *Massachusetts*—Acts 1921, ch. 268, § 1, p. 308, inserting new section 5A after § 5, Mass. Gen. L. 1921, p. 1624; Gen. L. 1921, Vol. 2, ch. 164, § 57, p. 1818; *Minnesota*—Gen. Stat. 1923, § 5305, p. 733, Mason's Stat. 1927, § 5305, p. 1107; *Missouri*—Rev. Stat. 1919, §§ 10470, 10488 and 10512, pp. 3250, 3266, 3283; *Nebraska*—Constitution Art. 10, § 5 (Comp. Stat. 1922, p. 96); *New Hampshire*—P. L. 1926, Vol. 2, ch. 240, §§ 9, 10, 11, p. 936; *New Jersey*—1911-1924, Cum. Supp. to Comp. Stat. Vol. 2, *167-17(f), p. 2883; *Ohio*—Throckmorton's Ann. Code, 1929, §§ 614-49 and 614-50, p. 161; *Oregon*—Olson's Or. L. 1920, Vol. 2, § 6046, p. 2422; *Pennsylvania*—Stat. 1920 (West Pub. Co.), §§ 18066, 18146, pp. 1742, 1752; *Tennessee*—Shannon's Ann. Code, 1926 Supp. § 3059a88(c), p. 733; *Wisconsin*—Stat. 1925, 196.09, p. 1550. Most of these statutes require the maintenance of a separate depreciation fund. Some require only a reserve. In Maryland, the Commission's power over accounting methods is held to include the power to require depreciation accounting, but not the maintaining of a separate fund. See Havre de Grace & P. Bridge Co. v. Public Service Commission (1918) 132 Md. 16, P.U.R.1918D, 484, 103 Atl. 319.

[51] See note 21, *supra;* G. O. May, Carrier Property Consumed in Operation and the Regulation of Profits, 43 Q. J. Ec. 208-214; R. A. Carter and W. L. Ransom, Depreciation Charges of Railroads and Public Utilities, a memorandum filed with the depreciation section of the Bureau of Accounts of the Interstate Commerce Commission (1921).

each year; that, therefore, no great disproportion in revenues and operating expenses in the various years results if the whole expenditure made for renewals or replacements in any year is treated as an expense of operation of that year and the retirements of property are not otherwise reflected in any specific charge. They admit that it may be desirable to create a special reserve, to enable the company to spread the cost of retiring certain large units of property over a series of years, thus preventing a disproportionate burden upon the operations of a single year. But they say that such a reserve is not properly called a depreciation reserve. Moreover they contend that when a large unit is retired, not because it has been worn out but because some more efficient substitute has been found, the cost of retirement should be spread over the future, so that it may fall upon those who will gain the benefit of the enhanced efficiency. Compare Kansas City Southern R. Co. v. United States (1913) 231 U. S. 423, 440–441, 58 L. ed. 296, 34 Sup. Ct. Rep. 125. Under the replacement method of accounting advocated by the railroads and others there is no depreciation charge and no depreciation reserve. Operating expenses are charged directly with replacements at their cost. This method does not concern itself with all retirements, but only with retirements which are replaced.[52]

Despite the seemingly unanswerable logic of a depreciation charge, they oppose its adoption, urging the uncertainties inherent in the predetermination of service life and of salvage value, and the disagreement among experts as to the most equitable plan of distributing the total net plant expense among the several years of service. They point out that each step in the process of fixing a depreciation charge is beset with difficulties, because of the variables which attend every determination involved. The first step is to estimate how long the depreciable plant will remain in service. Engineers calculate with certitude its composite service life by applying weighted averages to the data concerning the several property units. But their exactitude is delusive. Each unit has its individual life dependent upon the effect of physical exhaustion, obsolescence, inadequacy, and public requirement.[53] The physical duration of the life depends largely upon the conditions of the use; and these can-

[52] A modification of the depreciation reserve method is the "retirement reserve" recommended by the National Association of Railroad and Utilities Commissioners. This reserve does not involve necessary periodic charges of specific amounts to operating expenses. To this reserve are credited "such amounts as are charged to the operating expense account . . . appropriated from surplus, or both, to cover the retirement loss represented by the excess of the original cost plus cost of dismantling, over the salvage value of fixed capital retired from service." To the operating expense, "Retirement Expense" are charged "amounts . . . in addition to amounts appropriated from surplus, to provide a reserve against which may be charged the original cost of all property retired from service, plus cost of dismantling, less salvage." Proceedings, 37th Ann. Convention, 1925, pp. 441, 458; 32nd Ann. Convention 1920, Appendix 1, pp. 21, 76, 106, Appendix 2, p. 21, 88.

[53] The adequacy of a depreciation charge depends, among other things, upon the liberality of the particular concern's practice in respect to maintenance, 81 Amer. Soc. Civil Eng. Transactions (1917), 1490; R. H. Montgomery, Auditing Theory And Practice (1921) Vol. 1, p. 625. It depends in part upon the scope of the causes of retirement to be covered by it. As to what is the prop-

not be foretold. The process of obsolescence is even less predictable. Advances in the arts are constantly being made which would require retirement at some time, even if the unit were endowed with perpetual physical life. But these advances do not proceed at a uniform pace. The normal progress of invention is stimplated or retarded by the ever changing conditions of business. Moreover, it is the practical embodiment of inventions which produces obsolescence; and business conditions determine even more largely the time and the extent to which new inventions are embodied in improved machines. The march toward inadequacy, as distinguished from obsolescence, is likewise erratic.

The protestants point out that uncertainty is incident also to the second step in the process of fixing the appropriate depreciation charge. A plant unit rarely remains in service until consumed physically. Scrap remains; and this must be accounted for, since it is the net expense of the exhaustion of plant which the depreciation charge is to cover. Such scrap value is often a very large factor in the calculation of plant expense.[54] The probable salvage on the unit when retired at the end of its service life must, therefore, be estimated. But its future value is never knowable.

And, finally, the protestants show that after the net expense in plant consumption is thus estimated, there remains the task of distributing it equitably over the assumed service life—the allocation of the amount as charges of the several years. There are many recognized methods for calculating these amounts, each method having strenuous advocates; and the amounts thus to be charged, in the aggregate as well as in the successive years, differ widely according to the method adopted.[55] Under the straight line method, the aggregate of the charges of the several years equals the net plant expense for the whole period of service life; and the charge is the same for all the years. Under the sinking fund method, the aggregate of the charges of the several years is less than the net plant expense for the whole period; because the pro-

er scope, opinion differs widely. The telephone companies (Bell System) contend that the charge should cover all causes of retirement not provided for by ordinary maintenance charges, including extraordinary casualties like storm and fire. 118 Inters. Com. Rep. 340. Others insist that the charge should not include any allowance for contingent or presently unascertainable obsolescence, inadequacy, changes in the art, public requirements, storm casualties, or extraordinary repairs or expense of similar character. 118 Inters. Com. Rep. 341. Still others insist that the charge should cover only exhaustion due to wear and tear and lapse of time, collectively called superannuation, but not obsolescence, inadequacy, and the like, which are said to be precipitate in their operation. The Proposed Report of the Interstate Commerce Commission on Telephone and Railroad Depreciation Charges, Docket Nos. 14700 and 15100, August 15, 1929, pp. 27, 28, defines depreciation as "the loss in service value not restored by current maintenance and incurred in connection with the consumption or prospective retirement of property in the course of service from causes against which the carrier is not protected by insurance, which are known to be in current operation, and whose effect can be forecast with a reasonable approach to accuracy."

[54] In the case of telephone companies the value of the salvage recovered runs as high as 45 per cent of the original cost of the property. Testimony of Dr. M. R. Maltbie, note 16, *supra*, pp. 1459, 1460.

[55] Thus, if a unit costs $100, has a service life of 25 years and no salvage value, and the rate of interest is 5 per cent, the charge to operating expenses for depreciation in each of the following years would be:

ceeds of each year's charge are deemed to have been continuously invested at compound interest and the balance is assumed to be obtained from interest accumulations. Other methods of distributing the total charge produce still other results in the amount of the charges laid upon the operating expense of the several years of service.[56]

We have no occasion to decide now whether the view taken by the Interstate Commerce Commission in Telephone and Railroad Depreciation Charges (1926) 118 Inters. Com. Rep. 295 or the protest of the railroads, gas and electric companies should prevail.[57] For in neither event was the court of appeals justified in directing an increase in the allowance. The adequacy of a depreciation charge is dependent in large measure upon the practice of the individual concern with respect to its maintenance account. The Commission found that the Railways' property was well maintained and that the allowance of $883,544, together with the usual maintenance charges, would be adequate to keep the property at a constant level of efficiency. It found further, on the basis of the company's experience, that the charges previously allowed had served "fairly well" to take care of current depreciation and retirements. The depreciation charge was established by the Railways in 1912 and was fixed by it, of its own motion, at 5 per cent of the gross revenues. The charge at that rate had been continued ever since and had yielded each year an increasing sum. For the gross revenues had grown steadily. In the early years,

Year	Under Straight Line Method	Under Sinking Fund Method	Under Fixed Percentage of Diminishing Value Method	Under Annuity Method
5th	$4.00	$2.10	$8.05	$2.55
10th	4.00	2.10	3.21	3.25
15th	4.00	2.10	1.28	4.15
20th	4.00	2.10	.51	5.29
25th	4.00	2.10	.20	6.76
The aggregate of the charges in all the years at the end of the 25th year would be	$100.00	$52.38	$99.00	$100.00

See E. A. Saliers, op. cit., note 11, *supra*, 144, 148, 154, 161.

[56] Other methods are: reducing balance; annuity; compound interest or equal annual payment; unit cost; working hour; sum-of-the year-digits. See E. A. Saliers, op. cit., note 11, *supra*, 129–179; R. B. Kester, Accounting Theory and Practice (1918), Vol. 2, 150–186; J. B. Canning, The Economics of Accountancy (1929) 265–309; 81 Am. Soc. Civil Eng. Transactions (1917) 1463–1484.

[57] Nor need we express an opinion on the relation between a utility's depreciation reserve and the valuation of the accrued depreciation of its property. See Proposed Report of the Interstate Commerce Commission, note 14, *supra*, at pp. 20–24. While it is true that the annual depreciation charge does not purport to measure the current actual consumption of plant, it may be that the credit balance in the depreciation reserve is good evidence of the amount of accrued depreciation. See New York Teleph. Co. v. Prendergast, District Court, S. D. N. Y., decided November 7, 1929. It may also be that so much of the depreciation reserve as has not been used for retirements or replacements should be subtracted from the present value of the utility's property in determining the rate base, on the theory that the amounts thus contributed by the public represent a part payment for the property consumed or to be consumed in service. Compare Burns' Ann. Ind. Stat. (1926), Vol. 3, §§ 12693–12696, p. 1245. These matters are not involved in the case at bar and as to them no opinion is expressed.

they grew through increase of the number of passengers carried; since 1919, through the repeated increases in the rate of fare. In nearly every year, the allowance had exceeded the charges for retirements. After charging retirements, whether replaced or not, to the reserve, there remained a credit, on August 31, 1927, of $1,413,793. The allowance of $883,544 is equal to 5 per cent of the estimated gross revenues for 1928. The increase of this allowance for 1928 over that for 1914 was greater proportionately than the increase of the 1928 value of the Railways' property over its 1914 value.[58]

The estimated charge of $883,544 was thus clearly ample as the year's share of the expense of plant retirement based on cost. But even if the annual depreciation allowance could be made to correspond with the actual consumption of plant, there was nothing in the record to show that the value of the part of plant to be consumed in 1928 would exceed that amount. Nor is there anything in the record or in the findings to show that $883,544, together with the usual maintenance charges and under the improved methods of construction, would be inadequate to provide, at the prices then prevailing, for the replacements required in that year, and also for the year's contribution to a special reserve under the plan advocated by the railroads before the Interstate Commerce Commission. On the contrary, the company's history [59] and the present advances in the street railway industry strongly indicate that, by employing new equipment of lesser value,[60] the Railways could render more efficient service at smaller operating costs. Neither the trial court nor the court of appeals made any finding on these matters. The Commission's finding that $883,544 was an adequate depreciation charge should, therefore, have been accepted by the court of appeals, whether the sum allowed be deemed a depreciation charge properly so called, or be treated as the year's contribution to a special reserve to supplement the usual maintenance charges.

It is clear that the management of the Railways deemed the charge of 5 per cent of gross revenues adequate. On that assumption it paid dividends on the common stock in each year from 1923 through 1927.[61] If the addition to the depreciation charge ordered by the court of appeals was proper for the year 1928, it should have also been made in the preceding five years.[62] Upon such a recasting

[58] In determining the reproduction cost of the company's depreciable property, the Commission applied an index figure of 1.54 to the 1914 value. P.U.R.1926C, 441, 464. If the depreciation charge for 1914, $469,395, is multiplied by the same index figure, the product is $160,676 less than the allowance originally made for 1928. The additions to plant since 1914, $7,500,000, required a proportional increase in the depreciation charge of only $145,500.

[59] See Re United R. & Electric Co. (1928) P.U.R.1928C, 604, 633, 634.

[60] See 73 Electric Ry. Journal (1929) 693, 705, 758, 831, 843.

[61] The company was not, of course, restricted to a depreciation charge of 5 per cent of gross revenues. That was only the amount which the Commission deemed adequate. But the company was free to reserve a greater amount, without paying dividends, if it believed a greater amount was necessary. Cf. Havre de Grace & P. Bridge Co. v. Public Service Commission (1918) 132 Md. 16, P.U.R.1918D, 484, 103 Atl. 319.

[62] The value of the depreciable property in each of the five years preceding 1928 was almost constant and at least equal to that in 1928, P.U.R.1928C, 604, 639, P.U.R.1929A, 180, 183.

of the accounts, no profits were earned after 1924; and there was no surplus fund from which dividends could have been paid legally. If the contention now urged by the Railways is sound, the management misrepresented by its published accounts its financial condition and the results of operation of the several years; and it paid dividends in violation of law.[63]

Mr. Justice HOLMES joins in this opinion.

Opinion of Mr. Justice STONE: I agree with what Mr. Justice Brandeis has said, both as to the propriety of excluding from the rate base the value of the franchise or easement donated to the Railway Company and with respect to the method of ascertaining depreciation. But of this I would say a further word.

I will assume, for present purposes, that as a result of Smyth v. Ames (1898) 169 U. S. 466, 42 L. ed. 819, 18 Sup. Ct. Rep. 418, the function of a depreciation account for rate-making purposes must be taken to be the establishment of a fund for the replacement of plant rather than the restoration of cost or value of the original plant investment. But what amount annually carried to reserve will be sufficient to replace all the elements of a composite property purchased at various times, at varying price levels, as they wear out or become obsolete, is a question, not of law but of fact. It is a question which must be answered on the basis of a prediction of the salvage value of the obsolete elements, the character of the articles which will be selected to replace them when replacement is necessary, and their cost at the time of replacement.

Obviously, that question cannot be answered by *a priori* reasoning. Experience is our only guide, tempered by the consideration of such special or unusual facts and circumstances as would tend to modify the results of experience. Experience, which embraces the past fifteen years of high price levels, and the studies of experts, resulting in the universally accepted practice of accountants and business economists, as recounted in detail by Mr. Justice Brandeis, have demonstrated that depreciation reserve, calculated on the basis of cost, has proven to be the most trustworthy guide in determining the amount required to replace, at the end of their useful life, the constantly shifting elements of a property such as the present. Costs of renewals made during the present prolonged period of high prices and diminishing replacement costs tend to offset the higher cost of replacing articles purchased in periods of lower prices. I think that we should be guided by the experience and practice in the absence of

[63] In each of those years annual dividends amounting to $818,448 were paid. The recorded surplus at the beginning of 1923 was $1,553,097.83. If the depreciation allowance contended for had been made in each of those years, this surplus would have been wiped out in 1925 and there would have remained a deficit, after payment of dividends of $416,568 in 1925, $1,027,837 in 1926, and $2,140,146 in 1927. Instead, the Railways reported a surplus of $2,005,473 at the end of 1925, $2,020,863 at the end of 1926, and $1,588,823 at the end of 1927. See Moody's Manual of Investments (Public Utilities) 1929, pp. 375, 376; Poor's Public Utility Section 1929, p. 968. In declaring these dividends, the managament did not overlook the necessity of adequate provision for depreciation. For, in the several rate cases before the Commission it had insisted that the depreciation allowances were inadequate.

proof of any special circumstances showing that they are inapplicable to the particular situation with which we are now concerned.

Such proof, in the present case, is waning. The only circumstance relied on for a different basis of depreciation, and one which is embraced in that experience, is the current high price level, which has raised the present reproduction value of the carrier's property, as a whole, above its cost. That, of course, might be a controlling consideration if we were dealing with present replacements or their present cost, instead of replacements to be made at various uncertain dates in the future, of articles purchased at different times in the past, at varying price levels. But I cannot say that since prices at the present moment are high, as a result of post-war inflation, a rate of return which is sufficient to yield 7.78 per cent on present reproduction value, after adequate depreciation based on cost of the carrier's property, is confiscatory because logic requires the prediction that the elements of petitioner's property cannot, in years to come, be renewed or replaced with adequate substitutes, at less than the present average reproduction cost of the entire property—and this in the face of the facts that the cost of replacements in the past fifteen years has been for the most part at higher price levels than at present, that the amount allowed by the Commission for depreciation has been in practice more than sufficient for all replacement requirements throughout the period of higher price levels, and that the company has declared and paid dividends which were earned only if this depreciation reserve was adequate.

To say that the present price level is necessarily the true measure of future replacement cost is to substitute for a relevant fact which I should have thought ought to be established as are other facts, a rule of law which seems not to follow from Smyth v. Ames, *supra,* and to be founded neither upon experience nor expert opinion and to be unworkable in practice. In the present case it can be applied only by disregarding evidence which would seem persuasively to establish the very fact to be ascertained.

INDIANA PUBLIC SERVICE COMMISSION

Northern Indiana Telephone Company

v.

Winona Telephone Company et al.

[No. 9852.]

***Discrimination** — Telephone service — Uniformity of toll rates.*

Free telephone service in one direction and toll service in the other di-

rection between two exchanges is discriminatory and unlawful, and such a situation should be corrected.

[September 13, 1929.]

COMPLAINT *by one telephone utility against toll rates of connecting exchanges; rates adjusted.*

APPEARANCES: L. C. Loughry and C. H. Mote, for petitioner; F. E. Shortemeier for Urbana Telephone Company; Goodrich and Emison, for Winona Telephone Company, Commercial Telephone Company, Royal Telephone Company, Public Service Telephone Company, Twelve-Mile Telephone Company, Denver Telephone Company, Roann Telephone Company, Whitley County Telephone Company, and Pierceton Telephone Company; Henry Barnhart, for Rochester Telephone Company.

ELLIS, Commissioner: On July 20, 1929, the Northern Indiana Telephone Company filed with the Public Service Commission of Indiana its petition as follows: [Petition omitted.]

The matter was set for hearing in the rooms of the Commission, State House Indianapolis, Indiana, August 15, 1929, at 10 o'clock A. M. and legal notice of the time and place of said hearing given as required by law. All parties to the proceeding were present and represented by counsel except Nappanee Telephone Company, Tippecanoe Telephone Company, Bremen Home Telephone Company, Grass Creek Telephone Company, and LaGro-Andrews Telephone Company.

Evidence was heard which caused the Indiana Bell Telephone Company, by counsel to ask leave to intervene and permission to file an intervening petition was granted to said Indiana Bell Telephone Company when no objection was offered by any of the parties. It was thereupon agreed that the matter in which the Indiana Bell Telephone Company is interested and certain other matters mentioned in the petition should be made the subject of a further hearing at a later date and the hearing then in progress was largely confined to the question of the establishment of certain toll rates, concerning which question had been raised by the order of the Commission in Cause No. 9379, approved February 1, 1929. [See P.U.R. 1929A, 74.] It was further agreed that this matter might be made the subject of an interlocutory order by the Commission, if the Commission desired to take such action. The evidence showed that Order No. 9379, being in the matter of the petition of Northern Indiana Telephone Company for authority to increase rates, approved February 1, 1929, authorized said Northern Indiana Telephone Company to take the following action, "it is further ordered that the Standard Indiana Bell Telephone Company toll rates shall apply, except as herein set out for free service." Under the

proof of any special circumstances showing that they are inapplicable to the particular situation with which we are now concerned.

Such proof, in the present case, is waning. The only circumstance relied on for a different basis of depreciation, and one which is embraced in that experience, is the current high price level, which has raised the present reproduction value of the carrier's property, as a whole, above its cost. That, of course, might be a controlling consideration if we were dealing with present replacements or their present cost, instead of replacements to be made at various uncertain dates in the future, of articles purchased at different times in the past, at varying price levels. But I cannot say that since prices at the present moment are high, as a result of post-war inflation, a rate of return which is sufficient to yield 7.78 per cent on present reproduction value, after adequate depreciation based on cost of the carrier's property, is confiscatory because logic requires the prediction that the elements of petitioner's property cannot, in years to come, be renewed or replaced with adequate substitutes, at less than the present average reproduction cost of the entire property—and this in the face of the facts that the cost of replacements in the past fifteen years has been for the most part at higher price levels than at present, that the amount allowed by the Commission for depreciation has been in practice more than sufficient for all replacement requirements throughout the period of higher price levels, and that the company has declared and paid dividends which were earned only if this depreciation reserve was adequate.

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authority for this order, the petitioner has established a toll charge for service between certain of its own exchanges and between certain of its exchanges and the exchanges of connecting companies. No toll charge, however, is being made for calls originating at said exchanges of connecting companies to exchanges of the petitioner. This situation in the opinion of the Commission obviously is one which should be corrected. A somewhat similar condition has been before the North Dakota Board of Railroad Commissioners, (Kathryn Teleph. Co. v. Strinden (1926) P.U.R.1926D, *729*) and the decision held that free service in one direction and toll service in the other direction between two exchanges is discriminatory and unlawful.

The following table illustrates the situation as it now exists in this territory:

Northern Indiana Telephone Company.

From	To	Air Line Miles	Toll or Free Service
(a) Bourbon	(b) Plymouth	9	Toll
(a) Millwood	(b) Bremen	7½	Toll
(a) Millwood	(b) Nappanee	5½	Toll
(a) Millwood	(b) Milford	9	Toll
(a) Millwood	(b) Leesburg	8½	Free
(a) Atwood	(b) Leesburg	7½	Free
(a) Mentone	(b) Tippecanoe	4	Toll
(b) Tippecanoe	(a) Mentone	4	Free
(a) Bourbon	(b) Tippecanoe	5½	Toll
(b) Tippecanoe	(b) Bourbon	5½	Free
(a) Mentone	(b) Rochester	10	Toll
(a) Mentone	(b) Warsaw	9½	Toll
(a) Mentone	(a) Akron	8½	Free
(a) Akron	(b) Rochester	8	Toll
(a) Akron	(a) Macy	6½	Toll
(a) Akron	(b) Roann	10	Toll
(b) Roann	(a) Akron	10	Free
(a) Macy	(a) Fulton	6½	Free
(a) Macy	(b) Rochester	6½	Toll
(a) Macy	(b) Denver	6½	Free
(a) Fulton	(b) Rochester	7	Toll
(a) Fulton	(b) Grass Creek	6½	Free
(a) Fulton	(b) Twelve-Mile	4	Free
(a) Fulton	(b) Denver	10	Toll
(a) Macy	(b) Roann	11	Free
(a) North Manchester	(b) Roann	9	Toll
(a) Bippus	(b) Urbana	9½	Toll
(b) Urbana	(a) Bippus	9½	Free
(a) Sidney	(b) South Whitley	5½	Free
(a) South Whitley	(a) Sidney	5½	Free
(a) Sidney	(b) Pierceton	5½	Toll
(b) Pierceton	(a) Sidney	5½	Free
(a) Claypool	(b) Warsaw	6	Toll
(a) Burket	(b) Warsaw	7–	Toll
(a) Silver Lake	(b) Warsaw	9½	Toll
(a) Atwood	(b) Warsaw	6	Toll
(a) Bippus	(b) Andrews	5½	Toll
(a) Macy	(b) Grass Creek	13	Toll
(a) Macy	(b) Chili	7	Free
(a) Bippus	(b) South Whitley	10	Toll
(b) South Whitley	(a) Bippus	10	Free
(a) Macy	(a) Akron	6½	Free

(a) Company owned.
(b) Connecting exchanges.

The Commission being fully advised in the premises is of the opinion that the prayer of the original petition, under division (a) should be approved and it will be so ordered.

It is therefore *ordered* by the Public Service Commission of Indiana, that the Northern Indiana Telephone Company and its connecting companies involved in this proceeding, be and they are authorized and directed to place in effect, ten days from the date of this order, the Standard Indiana Bell Telephone Company toll rates, both ways, between the exchanges listed in the petition herein, where one way toll rates are now in effect and also between the following exchanges of the Northern Indiana Telephone Company, Mentone, and Akron, Macy and Akron, Macy and Fulton and also between Fulton and Macy exchanges of the petitioner and all exchanges of connecting companies involved in this proceeding.

It is further *ordered*, that the Commission retain jurisdiction of this cause for the purpose of making such final order in regard to other matters presented by the petition as may be in accordance with the law and evidence.

CALIFORNIA RAILROAD COMMISSION

Re Delta Warehouse Company et al.

[Decision No. 21544, Application No. 15661.]

Consolidation, merger, and sale — Invalid transaction — Ratification.

1. The law makes no provision for the validation or ratification of unauthorized transactions by utilities, and if approval of the Commission is subsequently granted, the parties must execute new instruments, p. 256.

Consolidation, merger, and sale — Permissive character of Commission consent.

2. Approval of a proposed transfer or lease is permissive only and in no way mandatory upon either party, p. 256.

[September 12, 1929.]

APPLICATION *of a utility for authorization of its sale and transfer; granted.*

APPEARANCES: E. D. Wilkinson, for Delta Warehouse Company; C. P. Cutten and R. W. DuVal, by R. W. DuVal, for Pacific Gas & Electric Company.

By the COMMISSION: In this proceeding the Railroad Commission is asked to make its order authorizing Delta Warehouse Company to sell certain properties to Pacific Gas & Electric Company, and Pacific Gas & Electric Company to lease the same properties to Delta Warehouse Com-

pany. The properties are described as follows:

All that real property, together with the appurtenances situate in the city of Stockton, county of San Joaquin, state of California, and more particularly described as follows, to-wit:

Block Sixteen and Two-Thirds (16⅔) West of Center street, according to the Official Map or Plat of the city of Stockton.

Delta Warehouse Company is a corporation engaged as a public utility in the business of storing grain in the city of Stockton. It appears that in April, 1928, it sold to Pacific Gas & Electric Company for the cash sum of $60,000 the aforesaid properties, which consist of a parcel of real estate and a brick warehouse building, approximately 200 by 300 feet in dimension, known as Delta Warehouse No. 2, and, at or about the same time, under an agreement dated May 1, 1928, leased such properties from Pacific Gas & Electric Company for a term of thirteen months and ten days, commencing April 21, 1928, and ending May 31, 1929, at the monthly rental of $300, with provision made for the tenancy of the properties by Delta Warehouse Company subsequent to the termination of the lease on a month-to-month basis at the monthly rental of $300. This amount since has been reduced to $200 a month.

[1, 2] The companies did not obtain permission from this Commission to sell or lease the properties. It appears, however, that their failure to do so was through inadvertence and with no intent to evade the provisions of the Public Utilities Act. When the matter of the necessity of obtaining the Commission's approval was brought to their attention, they filed this present application requesting the Commission's approval and presented evidence indicating, in our opinion, that the two transactions will not adversely affect the public interest. On this point E. D. Wilkinson, the secretary of the Delta Warehouse Company, testified that in the event of the termination of the lease arrangements with Pacific Gas & Electric Company, the remaining facilities of Delta Warehouse Company would be ample to take care of all goods offered it for storage. The testimony herein further shows that Pacific Gas & Electric Company has purchased the properties for use, in the future, in the expansion of its gas facilities and properties in the city of Stockton. The properties are adjacent to other properties it now owns and, it is reported, are suitable as a site for gas holders and other equipment necessary in the gas business.

In reviewing the record, then, it appears to us that we should authorize the transfer and lease of the properties referred to herein. Although these transactions were made in April, 1928, the attention of applicants is directed to § 51 (*a*) of the Public Utilities Act, which provides in part that every sale, lease, assignment, mortgage, disposition, encumbrance, merger, or consolidation of properties necessary or useful in public utility business made other than in accordance with an order of the Commission authorizing the same shall be void. The act makes no provision for the validation or ratification by the Commission of unauthorized

transactions after they have been made and, in our opinion, the approval of the Commission is a condition precedent to the transfer, or lease, of utility property. We believe, therefore, that the parties must execute new instruments following the effective date of the order in this matter if they desire to transfer or lease the properties. The action of the Commission in matters of this nature is, of course, permissive only and in no way mandatory upon the parties to sell or lease properties.

MISSOURI PUBLIC SERVICE COMMISSION

George G. Youngblood

v.

Christian County Farmers Rural Telephone Association

[Case No. 6588.]

Public utilities — Telephone association — Service to public.

1. An alleged mutual telephone company whose by-laws showed an unmistakable purpose to render service to the public for hire and whose members were compelled to charge nonsubscribers for the use of telephone equipment was held to be a public utility, notwithstanding the fact that the operator of the company received practically all of the fees for his services as operator and general utility man, p. 262.

Public utilities — Telephone company — Delegation of powers.

2. A telephone company will not be permitted to delegate its authority to some employee and permit the employee to use the telephone property for the service of the general public, charging for such use, and thereby escape the statutory requirements of public utilities, p. 262.

Certificates — Operation in good faith prior to regulation.

3. A telephone utility in existence and operating as a utility before the enactment of the Public Service Commission Law will not be required to file an application for a certificate of convenience and necessity, p. 262.

Public utilities — Telephones — Operation without lawfully filed schedule.

4. A telephone company purporting to be a mutual association but operating in fact as a public utility without having filed the necessary schedules required by law must take one of three courses, namely: file such schedules forthwith, restrict service to a mutual membership, or abandon service entirely, p. 262.

[November 6, 1929.]

MISSOURI PUBLIC SERVICE COMMISSION

COMPLAINT against a mutual telephone company for failure to file schedules; schedules ordered to be filed.

Statement.

ING, Commissioner: This case originated on the complaint of George G. Youngblood, owner and manager of the Youngblood Telephone Company of Christian county, against the Christian County Farmers Mutual Telephone Association. The complaint alleges that the defendant is located at Ozark, Christian county, Missouri; "that the defendant has never reported as a telephone company to the state department; that it has never given in their property to the assessor nor paid any taxes, state or county; that the said company has let their system or property become decayed, dilapidated, and depreciated to such an extent that its poles are dangerous to the public travel and are unfit for telephone service." The complaint further alleges "that the said defendant has no established fee or charges and discriminates between its patrons or users; that is, if it makes a charge, one person will have to pay more than another. Some don't pay any fee, while others do."

The complaint further states that two telephone systems in a small town like Ozark are not necessary for the use and benefit of the public and that if there are two systems one tends to destroy the other.

Defendant filed an answer to the complaint in this cause and alleged, among other things, that it has been in operation for twenty-three years, "that the above named defendant has never reported as a telephone company to the State department. Defendant replies that it has never been and is not considered a telephone company but merely as an association or cooperative organization of farmers and others for the service of themselves without profit or compensation." There are various other allegations in the answer, but since the issue at the hearing was whether the applicant is a public utility or a mutual company, it is unnecessary to quote further from either complaint or answer.

A hearing was held in this case by a member of the Commission at Ozark, Missouri, on September 27, 1929, at which hearing G. Purd Hays of Ozark appeared for the complainant and Charles F. Boyd of Ozark for the defendant.

Facts.

The facts developed in this proceeding show that the Youngblood Telephone Company of Christian county is owned and controlled by the complainant, George G. Youngblood. The name of the telephone company was formerly Ozark Christian County Telephone System, and was purchased by Mr. Youngblood about two years ago. It consisted of exchanges at Ozark and Chadwick, Missouri, and telephone lines from Ozark to Nixa, 8 miles west of Ozark, from Ozark to Sparta, about 8 miles east of Ozark, a line between Ozark and Chadwick and a metallic toll line between Ozark and Linden, at which place the company also

maintains a switchboard. Complainant also maintains and operates a few farmer lines which are connected with its switchboards. The complainant is rendering a general local and long distance telephone service, the long distance service being by a connection with the Southwestern Bell Telephone Company. There is very little controversy relative to the facts in this case.

The testimony shows that the defendant was organized for the purpose of engaging in the telephone business at Ozark and vicinity. The by-laws of the company provide that "Every person owning a 'phone or 'phone right in this system shall pay an annual fee of $1 into their party line treasury, said money to be turned over to the treasurer of the general system." It is further provided in the by-laws that "All persons or parties may become members of the Ozark Co-Operative Rural Telephone Company by signing the constitution and by-laws." It will be noted that the name of the defendant, as designated by its constitution and by-laws, is "Ozark Co-Operative Rural Telephone Company."

Sections 26, 27, and 28 of the defendant's by-laws provide as follows:

"Section 26. No member shall allow the use of his telephone free of charge to any person not a stockholder, except it be a member of his family, his partner in business, his employee, or guest who is actually visiting his family, or a poor person in case of sickness or death, or a member of another line who has free exchange with this line, and then only to a stockholder. Any member who shall violate any of the provisions of this article shall be charged with the full amount of the message so permitted.

"Section 27. Any member of any other company having free exchange with this line who shall request to be switched on this line for the purpose of sending a message for some other person, not a member of this or some interchanging line, in his own name shall be charged with the full amount of the message and on his refusal to pay the same he shall be denied the further use of the line.

Section 28. Any person (except those having free use of the line as provided for in the foregoing articles of these by-laws) shall pay the sum of 10 cents for each and every message to any part of the system and the additional amount of 10 cents or more when the person to whom the message is sent has to be sent for."

From the above it will be noted that the by-laws contemplate the payment of a fee for services by all persons who are not members of the company. The testimony as a whole shows that the business of the defendant is conductel by its operator. The president of the company and the secretary-treasurer of the company have but little personal knowledge of the business condition of the company and could make no definite explanation of its operations. All of the members and officers of the company agreed that the defendant's operator had entire charge and control of the company's business and the testimony, so far as the character of the service rendered by the defendant is concerned, may be rested upon the testimony of Fred McCoy, the defendant's operator. Mr. McCoy stated

that he has been operator for the defendant for more than three years; that he gets no salary for his services, but that he has an arrangement with the company whereby he is to receive for his services the fees paid by telephone subscribers and patrons. To quote directly from the transcript of the record, the arrangement as described by Mr. McCoy is as follows:

"Q. How are you paid for your service, do you get a regular stated salary?

A. No, sir.

Q. There is some arrangement?

A. Yes.

Q. State what the arrangement is.

A. I get what rates the phones pays in. All the phones in town pays me 35 cents and the country phones pay me 30 cents."

Mr. McCoy stated that in addition to the 35 cents from town subscribers and the 30 cents from country subscribers, he is allowed 30 cents per hour for work for the company, such as taking care of lines and looking after trouble generally. Each residence subscriber living in the town of Ozark is charged a minimum of 50 cents per month by Mr. McCoy. Business houses pay $1.25, doctors $2.50, dentists $1.25, and, as explained by Mr. McCoy, of each 50 cents paid by the residence subscribers, he keeps 35 cents for his services and credits 15 cents to the company for operating and upkeep expense. All of the fees by business houses, doctors, dentists, etc., are retained by the operator. Mr. McCoy stated that the money received and credited to the account of the company for office expense and upkeep of the lines is not sufficient, and each customer is assessed a sum to take care of the expense. The rates, like the service, is in the control of the operator. Again quoting from the record, the testimony of Mr. McCoy shows that fact:

"Q. You charge different prices for the phones in town?

A. Well the rates I have given—

Q. —who makes the rates in town?

A. I make them—I am in here for what I can get out of it, and if it is satisfactory for a man to pay me $3, all right, I am in here for what I can get out of it.

Q. I am asking if the Board, composed of Mr. Bilieu as president and Mr. Stein as secretary and treasurer —how many on the Board?

A. There are seven members on the Board.

Q. When you make a rate in town, you do not have to ask the Board of Directors about it?

A. I never have, if I got too high, maybe I would have to.

Q. —how long have you been running this to suit yourself?

A. Since I have been here.

Q. That is three years?

A. Yes, it will be four in April.

Q. It was three years last April?

A. Yes."

The testimony shows that the defendant maintains four telephones in the county courthouse, for which a fee of $1.50 each is paid by Christian county. Of this fee, Mr. McCoy stated that he retains 50 cents and credits the company with $1 per phone. Members of the defendant company had these phones installed

in the courthouse and the $1 per phone that is credited to the company is used to pay interest on a $400 note that was signed by company members to pay for the installation of the phones. There is no telephone line connecting the office of the defendant and the Youngblood Telephone Company of Christian county. The testimony also shows that the defendant receives from the Southwestern Bell Telephone Company 25 per cent of all tolls over the Bell line collected by Mr. McCoy, the agent and operator of the defendant. That also goes to Mr. McCoy and helps pay him for his services to the defendant. None of it is credited to the defendant. Mr. McCoy stated that the amount collected per month for the Bell Telephone Company varies from $80 to $142.50 per month, said amounts being the fees collected by Mr. McCoy on the defendant's contract with the Bell Company on outgoing calls. Mr. McCoy lives in a building belonging to the defendant, and for which he pays no rent, and also receives his heat free of charge. If any extra services, either as an operator or otherwise, are needed for the defendant, Mr. McCoy pays for them.

With reference to the service rendered by the defendant and Mr. McCoy's connection therewith, the following quotation from the record is pertinent:

"Q. Mr. McCoy, is there ever, at any time within a year's operations, any particular amount of money, or any considerable amount of money, I might say, on hands that belongs to the Association?

A. There never is what is collected in does not balance out and they have to pay me out of the revenue of the company.

Q. I presume that the company does not deny service to anybody who is able and willing to pay for it?

A. They don't deny anybody that is able, and they don't deny anybody that is not able."

Conclusions:

The question to be determined by the Commission in this case is whether the defendant is a mutual telephone company or a public utility. Paragraph 17 of § 10411, R. S. 1919, defines a telephone corporation as follows:

"The term 'telephone corporation,' when used in this act (chapter), includes every corporation, company, association, joint stock company, or association, partnership and person. their lessees, trustees, or receivers appointed by any court whatsoever, owning, operating, controlling or managing any telephone line or part of telephone line used in the conduct of the business of affording telephonic communication for hire."

Section 10425, R. S. 1919, provides as follows:

"The jurisdiction, supervision, powers, and duties of the Public Service Commission herein created and established shall extend under this act (chapter): * * *

6. To all telephone lines, as above defined, and all telegraph lines, as above defined, and to every telephone company, and to every telegraph company, so far as said telephone and telegraph lines are and lie, and so far as said telephone companies and said telegraph companies conduct and op-

erate such line or lines, respectively, within this state."

[1, 2] The jurisdiction of the Commission is determined by the facts relative to the character of service rendered by the defendant. If the defendant is engaged in "owning, operating, controlling, or managing any telephone line or part of telephone line, used in the conduct of the business of affording telephonic communication for hire," and if such service is rendered to the general public it is a public utility and subject to the jurisdiction of the Public Service Commission and amenable to all of the Public Service Commission laws relative to telephone corporations. If, on the other hand, the defendant renders service to its membership only, or to a limited number of people and does not use its property for the purpose of affording telephonic communication for hire to the general public, it is not a public utility but a mutual telephone company. The sections of the defendant's by-laws set out in the report in this case show an unmistakable purpose to render service to the public for hire. Its own members are compelled to charge non-members for the use of the defendant's telephone property, or to pay the specified fee themselves for said use. The mere fact that the operator of the defendant receives practically all of the fees for his services as operator and general utility man, does not change or modify the status of the company. A telephone company will not be permitted to delegate its authority to some employee and permit the employee to use the telephone property for the service of the genral public and charge for such use, and thereby escape the statutory requirements of public utilities. The owners of the defendant company are evidently in error as to what it takes to make a telephone company a public utility and what is required to constitute a mutual telephone company.

The Commission, in this case, under the facts, is compelled to hold that the defendant is not a mutual telephone company. Section 10505, R. S. 1919, provides,

"No telegraph corporation or telephone corporation hereafter formed shall begin construction of its telegraph line or telephone line without first having obtained the permission and approval of the Commission and its certificate of public convenience and necessity, after a hearing had upon such notice as the Commission may prescribe."

[3] It will be noted that the above section refers to telephone companies "hereafter formed," and since the defendant was in existence and operating as a telephone company before the enactment of the Public Service Commission Law, it will not be required to file an application for a certificate of convenience and necessity.

The Public Service Commission, by its General Order No. 1, provided that every telephone corporation engaged in business in the state of Missouri should file with the Commission, not later than September 15, 1913, such schedules of rates and charges as were in force on April 15, 1913. The defendant has not filed its schedules of rates and charges with this Commission.

[4] There are three courses left open to the defendant. One of them is to file with the Public Service Com-

mission its schedule of rates and rules governing its intercourse with its patrons and the general public, and in all respects comply with the law regulating public utilities. The other course is to cease serving the general public and confine its service to its membership, or in any event, to a limited number. Failing to take either of the above mentioned courses, there remains the alternative of abandoning telephone service entirely. The latter is not necessary, and the Commission suggests that the defendant should do either as suggested in the first or second alternative, that is, comply with the law regulating public utilities or cease to serve the public for hire.

An order in accordance with the views herein expressed will be issued.

Stahl, Chairman, and Hutchison, Commissioner, concur; Porter, Commissioner not sitting; Hull, Commissioner, absent.

NEW YORK DEPARTMENT OF PUBLIC SERVICE, METROPOLITAN DIVISION (TRANSIT COMMISSION)

Re Interborough Rapid Transit Company

(Case No. 2973.)

Procedure — Scope of Commission hearing — Jurisdictional question.

1. A Commission, by ordering a hearing upon the "issues of law and fact" presented by a complaint, does not thereby decide that it has jurisdiction to conduct the investigation demanded in the complaint, but questions of law relating to jurisdiction are "issues of law" for whose consideration the hearing was ordered, p. 266.

Procedure — Raising jurisdictional question — Commission initiative.

2. The Commission has power to raise the question of jurisdiction on its own initiative regardless of the conduct of parties, since it has neither power nor duty to act without jurisdiction and it must necessarily determine its existence in the case, p. 266.

Procedure — Limitation of hearing — Questions of law or fact.

3. The Commission may, in its discretion, limit the first hearing on a complaint against rates to the question of jurisdiction, p. 266.

Commissions — Injunction bar to Commission action — Restraint on rate proceedings.

4. So long as supreme court orders remain outstanding which restrain a company from charging or attempting to charge a fare in excess of the fare prescribed in a contract and from taking steps towards increasing the contract fare, the company can have no right to require the Commission to entertain a petition for authority to raise the fare, whether or not the Commission itself is bound by the orders, p. 268.

Commissions — Limitations — Pending suit in court.

5. The Commission cannot properly entertain a petition by a company for authority to increase fares above the amount provided in a contract while suits are pending in the supreme court to obtain an adjudication of the right to increase such fares, p. 269.

Procedure — Doctrine of election — Theory of rate proceedings.

6. A rapid transit company which has filed schedules under § 29 of the Public Service Commission Law, by which it elects to increase fares fixed by contract, is barred by the doctrine of election from initiating a rate proceeding under § 49 of the Public Service Commission Law to obtain Commission consent to increase the contract fares while it is still pressing, by affirmative defenses in supreme court suits, its right under § 29, to increase fares, p. 271.

Commissions — Abridgment of jurisdiction — Suit in court.

7. The Commission, after rejecting schedules containing fares in excess of those prescribed by contract, does not arbitrarily abridge its jurisdiction by merely instituting a suit in a state court and obtaining a temporary restraining order against the maintenance of a proceeding before the Commission to obtain the increased rates, p. 274.

Rates — Power of Commission to change — Contract authorized by legislature.

8. A fare limitation contained in a contract entered into between the city of New York, the Commission, and a rapid transit company, upon adequate consideration moving to the company, pursuant to the Rapid Transit Act, which provides a comprehensive legislative structure for rapid transit railways in the city, is not subject to the provisions of the Public Service Commission Act and cannot be changed by the Commission, 275.

Rates — Contract — Nonregulatable fare — Express authority.

9. The Rapid Transit Act, which authorized the Commission, with the approval of the board of estimate and apportionment of a city, in granting an elevated extension certificate, to fix and determine "such other terms, conditions, and requirements" in the certificate "as to the said boards may appear just and proper," expressly conferred the power upon the Commission and the city to contract with a rapid transit company for a nonregulatable rate of fare, p. 280.

[September 19, 1929.]

COMPLAINT *by a rapid transit company alleging that the present fare charged on its system of elevated railways yields an inadequate return, that it is subject to regulatory powers under the Public Service Commission Law, and that it should be increased to 10 cents; dismissed without prejudice to revive proceedings if outstanding restraining orders should be dissolved or if the jurisdiction of the Commission should otherwise be established or the litigation terminated.*

APPEARANCES: William L. Ransom (Charles E. Hughes, Jacob H. Goetz, Allen S. Hubbard, and John F. Caskey with him on the brief), Counsel for the Interborough Company; Samuel Untermyer, Special

Counsel for the Transit Commission, and Arthur J. W. Hilly, Corporation Counsel, for the city of New York (Nathan R. Margold, with them on the brief).

By the TRANSIT COMMISSION (all concurring):

On June 19, 1929, the Interborough Rapid Transit Company filed a complaint and petition alleging that the 5-cent rate of fare now charged on its system of elevated railroads known as the Manhattan Division yielded an inadequate return for the service rendered, that said rate of fare was subject to our regulatory powers under the Public Service Commission Law, and that it should be increased to 10 cents. The petition called on us to undertake an inquiry into the matters complained of by the company as the lessee of the elevated roads, to determine after a hearing that a 10-cent rate of fare was the just and reasonable rate of fare to be charged on the Manhattan Division, and, incident thereto, to provide for joint fares and transfers between the Manhattan Division and the Subway Division operated by the company under Contract No. 3. We are also asked, pending final determination, to establish a temporary rate on the Manhattan Division in excess of the present fare of 5 cents per passenger.

On July 18, 1929, we entered an order on this petition in which, after reciting that "having heretofore determined with respect to a somewhat similar application by the Interborough Rapid Transit Company for an increased fare on the Manhattan Division and the Subway Division jointly that it had no jurisdiction to alter the rate of fare fixed by contract between the company and the city and it being now claimed by the company that the present application is to be differentiated from that heretofore decided by the Commisson," we ordered "a hearing upon the issues of law and fact presented by the complaint."

The hearing was held on August 1, 1929. At its outset, we announced a desire to limit the argument at the initial session "to the question of the jurisdiction of the Commission to entertain, hear, and determine the petition," but at the suggestion of special counsel for the Commission, we decided that we would also hear argument and ask for briefs on the question of our right and whether (assuming that we should conclude that we had jurisdiction to entertain jurisdiction) we had the power, and if so, whether we should exercise our jurisdiction, for the reasons hereinafter stated.

We have now considered the elaborate briefs and reply briefs that were filed following the oral argument.

Counsel for the company objected to the limitation at this time of the hearing to the preliminary questions of law presented by the oral argument and briefs, and sought to proceed with the presentation of evidence on issues which presupposed our jurisdiction to inquire into the merits of the complaint. Not until our jurisdiction was formally challenged by a motion to dismiss the complaint and petition, did counsel for the company consent to proceed with the initial inquiry into the jurisdictional and other preliminary legal objections, and then

only subject to their exception to our ruling.

While these questions are thus before us on the motion to dismiss the petition, we cannot agree with the contention that we could not properly raise them on our own initiative. We are of opinion that it would have been our duty to do so in any event.

[1] The suggestion is made on behalf of the company that by provisionally and preliminarily ordering "a hearing upon the issues of law and fact presented by the complaint," we necessarily decided that we had jurisdiction to conduct the investigation demanded in the complaint. That was not our intention nor is it the legal effect of our action.

Quite apart from the recital in the order, which clearly negatives any such intention, we hold that the questions of law that have been submitted to us are "issues of law . . . presented by the complaint," and hence are issues for whose consideration and determination the hearing was ordered. The suggestion that we assumed and admitted jurisdiction by ordering an inquiry into its existence is untenable.

[2] The jurisdictional question and the right and discretion to entertain the petition at this time being open for consideration along with all the other issues of law and fact presented by the complaint, these questions of law were properly the first subject for inquiry. Unless jurisdiction and the right to entertain the application existed, there would be no necessity for a decision on the issues which presupposed their existence. There would be no justification for protracted and expensive hearings on those issues.

Considerations of reason and expediency thus dictated the delimitation of the initial inquiry sought to be imposed at the first hearing. Its imposition could not in any event have been an improper exercise of discretion as to the order in which the issues were to be considered and proof as to them to be introduced.

[3] The contention that we were powerless to raise any jurisdictional question on our own initiative is likewise without merit. Having neither power nor duty to act without jurisdiction, we are necessarily called upon to determine its existence in every case. This determination cannot be made to depend on the conduct of the parties who come before us. Their failure to challenge our jurisdiction at all, or to challenge it upon the proper grounds, cannot operate to confer powers and duties upon us which we would not otherwise have. Ours being the duty properly to determine our jurisdiction irrespective of objections or concessions by the parties in interest, ours must also be the power and duty to raise and decide objections to jurisdiction that have not been raised by the parties as well as to decide those which have been so raised.

While we are, therefore, of opinion that it was proper to limit the first hearing to the question of our jurisdiction and our right "to entertain, hear, and determine the petition," even in the absence of any formal motion to dismiss, and that the question may now be decided on grounds not urged in the motion, we are not required to depend on the initial delimitation nor to go beyond the

grounds of the motion that have been fully argued before us.

All but one of these grounds predicate the impropriety of the present proceeding upon the pendency of certain litigation in the supreme court of New York and of restraining orders issued therein. For a proper statement of them, it is necessary to set forth the salient facts with reference to that litigation.

The Manhattan Division is at present operated by the Interborough Company under the Elevated Extension Certificate of March 19, 1913 (hereinafter referred to as the Certificate), granted to the company by the Public Service Commission for the First District, consented to by the city of New York, pursuant to the provisions of the Rapid Transit Act, and accepted by the company. The Certificate provides (Article VI):

"The Interborough Company shall be entitled to charge for a single fare for each passenger for one continuous trip in the same general direction over the railroads (including the parts of the municipal railroad over which the Interborough Company is provided with trackage rights as in this certificate provided) and the additional tracks (which shall mean the additional tracks authorized by the Commission by certificate to the Manhattan Railway Company bearing even date herewith) and the Manhattan Railroad the sum of 5 cents but not more."

On February 1, 1928, the company, purporting to act under and pursuant to § 29 of the Public Service Commission Law, filed certain revised tariff sheets by which it sought to put into effect on and after March 3, 1928, a 7-cent rate of fare on its Subway Division, as well as on its Manhattan Division, in lieu of the maximum 5-cent rate of fare permitted by Contract No. 3 as to the Subway Division and by the Certificate as to the Manhattan Division.

On February 14, 1928, we rejected the tariff sheets as unlawful and ineffective to increase the rate of fare fixed in the contracts between the city of New York and the company and embodied in Contract No. 3 and in the Certificate. We also instructed our special counsel to institute a special proceeding in the supreme court, New York county, pursuant to § 57 of the Public Service Commission Law, to enjoin the company from putting its revised schedules into effect and from taking any other or further action to increase its fare beyond the maximum contractual 5-cent rate fixed in Contract No. 3 and in the Certificate.

The special proceeding was filed the same day, and Mr. Justice Glennon immediately granted a temporary restraining order enjoining the company, its officers, agents, and employees, and each of them, "from charging or attempting to charge any fare on the subway and elevated lines referred to in the annexed petition in excess of the fare of 5 cents and from in any way forcing, compelling, or attempting to compel the payment of any fare in excess of said 5 cents," pending the determination of a motion for an interlocutory injunction made by the Commission.

Simultaneously with the commencement of that proceeding, similar relief was sought in a suit instituted by the Commission in the supreme court, New York county, in the name

and on behalf of the city of New York, and in a suit brought in the same court directly by the city. Mr. Justice Glennon issued and filed a restraining order in the suit precisely similar to the one in the special proceeding. In the suit by the city, Mr. Justice Glennon likewise issued and filed a temporary restraining order which enjoined the company, its officers, agents, and employees, "from carrying out its threat to increase its fare from 5 cents to 7 cents and from taking any steps tending or looking toward said increase of fares on the subway and elevated railroads and from in any way violating or ignoring the provisions fixing a 5-cent fare contained in said Contract No. 3 and in said Certificate."

These orders have ever since been and are now in full force and effect. During all this time the company has had the opportunity to oppose the motion for an interlocutory injunction or to move to dissolve it and to seek a determination on the merits in the state court suits. Instead of availing itself of this opportunity, it sought in the first instance to defeat the orderly prosecution of the state court suits and special proceeding by beginning a suit and procuring a temporary injunction in the United States District Court for the Southern District of New York against the further prosecution of the suits and proceeding.

On appeal, the order granting that temporary injunction was reversed by the Supreme Court of the United States on the ground, among others, that it improperly interfered with the orderly administration of justice, which required the company to obtain an adjudication of its rights in the suits and proceeding in the state court before attempting to assert in the Federal court a deprivaton of its property without due process of law as a result of continued operation of the Manhattan Division and of the Subway Division at a 5-cent rate of fare (Gilchrist v. Interborough Rapid Transit Co. (1929) 279 U. S. 159, 73 L. ed. —, P.U.R.1929B, 434, 454, 49 Sup. Ct. Rep. 282.) The Court said:

"The Transit Commission has long held the view that it lacks power to change the 5-cent rate established by contract; and it intended to test this point of law by an immediate orderly appeal to the courts of the state. This purpose should not be thwarted by an injunction."

Instead of proceeding to obtain an adjudication of its rights in the pending suits and proceeding in the state court, the company has filed this petition.

The first two grounds in support of the motion to dismiss the petition challenge the right of the company to maintain this proceeding in violation of the restraining orders, and to defeat the orderly determination of its rights which it can and should obtain by means of an adjudication in the state court suits and proceeding.

[4] The first ground is based specifically on the restraining orders and requires a dismissal of the present application without prejudice to its renewal if the reason for the objection shall be removed by the defeat of the Commission and the city in the pending state court suits and special proceeding.

We cannot accept the contention that the state court orders enjoin the

company merely from putting into effect the 7-cent fare specified in the revised schedules supposedly filed under § 29. While the effort of the company to put those schedules into effect afforded the immediate occasion for the institution of the state court litigation, its frustration was neither the sole nor the primary purpose of that litigation. The primary purpose was to establish that the company was bound by a nonregulatable contract to serve at a 5-cent rate of fare, to compel the company to abide by its contract and to enjoin any further or other attempts to violate or circumvent the contract provisions to maintain the 5-cent fare.

The restraining orders likewise were directed, not merely at the attempt to increase the fare to 7 cents attempted under § 29, but at any attempt to charge or to compel the payment of any fare in excess of 5 cents or to violate or ignore the fare provision in the certificate.

The present proceeding is manifestly part of an attempt to compel the payment of a fare in excess of 5 cents. By seeking to maintain it, the company is "violating or ignoring the provisions fixing a 5-cents fare contained . . . in said certificate" and hence is violating the plain mandate of the state court injunctions.

The contention is pressed, however, that this violation is cognizable only in the state court which has issued the injunction and does not affect the right of the company to proceed here in its defiance.

It is questionable whether we could aid and abet the company's contempt of the orders of the state court by permitting the maintenance and prosecution of the present proceeding, and yet ourselves remain free of contempt. But assuming that the company rightly urges this to be the case because the restraining orders are not directed against us, and hence that we are not *prohibited* from entertaining the proceeding, it does not follow that we are *required* to do so. The question is not alone whether we should be guilty of contempt, but whether the company has any reasonable claim of right now to invoke our aid that we are bound or ought to recognize at this time in the face of these orders even if we had otherwise the jurisdiction to do so.

The company's right depends entirely on whether *it* is bound by the injunctions, and not at all on whether we are bound by them. So long as the restraining orders are effective *as against the company,* so long do they place that company under a temporary disability and strip it of every conceivable present right to take any step or action in an attempt to increase the 5-cent rate of fare.

That they are effective as against the company cannot well be open to dispute. They were issued by a court, with jurisdiction over the company and the subject-matter and with power to bind the company and suspend its rights. So long as the orders remain outstanding, the company can have no right to require us to aid and abet its attempt, in violation of them, to increase the 5-cent rate of fare on the Manhattan Division.

[**5**] The second ground urged in support of the motion to dismiss is based on the continued pendency of the state court litigation prior to and

ever since the commencement if there were no such orders outstanding, even though we had otherwise jurisdiction to entertain the petition.

The basic rights upon which the company must rest its claim to relief are precisely the same here as in the state court litigation. Their existence depends necessarily upon the question whether the 5-cent rate of fare has been fixed by a contractual provision that is not subject to regulation and change under the Public Service Commission Law. That question was properly raised in the state court litigation more than fifteen months prior to the commencement of the present proceeding and has been pending there ever since. The very purpose of that litigation was to obtain an authoritative adjudication upon it by the proper tribunals. If the Interborough had so chosen, it could have had that question taken through the courts and long since determined by the court of appeals, for the cases are entitled to a preference in all the courts.

The Supreme Court of the United States held it improper for the Federal courts to thwart the purpose of that litigation. (Gilchrist v. Interborough Rapid Transit Co. (1929) 279 U. S. 159, 211, 73 L. ed. —, P.U.R.1929B, 434, 49 Sup. Ct. Rep. 282.) We deem it equally improper for us to do so. (New Bremen v. Public Utilities Commission (1921) 103 Ohio St. 23, P.U.R.1921E, 742, 132 N. E. 162; Federal Gas & Fuel Co. v. Public Utilities Commission (1925) 112 Ohio St. 717, P.U.R.1926A, 646, 148 N. E. 685.)

In the New Bremen Case, *supra*, the New Bremen-Minster Gas Company applied to the Ohio Commission for permission to discontinue supplying natural gas to the villages of New Bremen and Minster, on the ground that all the available supply of natural gas had been exhausted. The villages opposed the application on the ground that the gas company was bound by contract to continue the service and that the question whether it could discontinue was involved in a suit to enjoin the gas company from discontinuing its service, which had been brought in the state court prior to the application and was still pending and undetermined there. The Commission nevertheless heard the application and granted the gas company the desired permission to discontinue further service.

On appeal, the supreme court of Ohio reversed the Commission's order, saying (103 Ohio St. at p. 32, P.U.R.1921E, at p. 749):

"As shown by the record, there is pending in a court of competent jurisdiction, the court of common pleas of Auglaize county, a proceeding invoking the jurisdiction of the court for the judicial determination of the very question presented on the application to the Commission and the rights of the parties in connection with the facilities described in that application. That proceeding in the court of common pleas was brought before the filing of the application in this case. The court of common pleas had acquired full jurisdiction of the subject-matter and of the parties and when this situation was shown by the answer of the villages, and the testimony in the proceeding before the Public Utilities Commis-

sion, it was its duty under this state of facts to dismiss the petition."

In the Federal Gas & Fuel Company Case, *supra*, the suit pending in the state court was radically different from the application made to the Commission. The suit had been brought by consumers of gas to enjoin the gas company from discontinuing service which it theretofore had furnished these consumers. The application to the Commission was by nonconsumers who sought to compel the gas company to extend service to them never theretofore rendered. The gas company opposed the application on the grounds: (1) that it was bound by no contract to furnish gas to anyone; (2) that it had ceased to be a public utility, and (3) that the proceeding before the Commission would directly affect the rights involved in the state court suits commenced before and pending at the time the proceeding was instituted. The Commission, after a hearing, decided the case upon the merits and ordered the gas company to extend service to certain of the petitioners.

On appeal, the Ohio supreme court reversed the Commission's order, saying (112 Ohio St. at p. 720, P.U.R. 1926A, at p. 648):

"Inasmuch as the record shows that the complaint filed with the Public Utilities Commission and the order prayed for directly affect rights involved in the cause pending in the court of common pleas of Franklin county, the Commission has no jurisdiction of the complaint. The order must, therefore, be reversed upon the authority of the case of New Bremen v. Public Utilities Commission, 103 Ohio St. 23, P.U.R.1921E, 742, 132 N. E. 162."

In the Federal Gas Case, *supra*, the only similarity between the litigation in the state court and the proceeding before the Commission was that the merits of each ultimately turned on the question whether the gas company was bound by contract to serve the community. On the decision of that question rested its obligation to continue to serve existing consumers as well as its duty to commence to serve new ones. This being so, the court held it improper for the Commission to have interfered with the orderly decision of that question in the state court suits, where it was first presented.

Likewise, in the proceeding now before us, the merits both of this proceeding and of the state court litigation ultimately turn upon the question whether the company is bound by a nonregulatable contract to serve at a 5-cent rate of fare; and we are persuaded that it would be equally improper for us to interfere with the orderly decision of that question in the state court, where it was raised before the present proceeding was commenced, where it was pending at the time the present proceeding was commenced, and where it has ever since remained pending and undetermined and might long since have been decided if the company had so chosen.

[6] In connection with the ground just considered, it has been further urged that the adoption by the company in February, 1928, of the remedy afforded by § 29 of the Public Service Commission Law constituted an election which at least precludes it from resorting to the remedy afforded

by § 49 in this proceeding, while it is still seeking to avail itself of the former in the state court litigation.

The remedy that the company is invoking in this proceeding is based on a claim of right which is irreconcilable with that on which are based its affirmative defenses in the state court litigation. Here it claims that a 5-cent rate of fare is now properly in force on its Manhattan Division, that such rate of fare is unreasonably low and that while it never has been changed since March 19, 1913, it should now be increased to 10 cents by the Commission. In the state court litigation the affirmative defenses interposed by the company rest, on the contrary, on the claim that the 5-cent rate of fare *has been* abrogated by it pursuant to the provisions of § 29 of the Public Service Commission Law, and that the 7-cent fare fixed in the revised schedules filed by the company on February 1, 1928, under that section, is the only rate legally in force and properly enforceable at the present time.

The insistence upon rights which the company could have obtained only by electing to follow the remedy provided by § 29, the reaffirmance of the election of and adherence to that remedy, is indicated not merely by the company's answers in the state court litigation, but also by its declaration in the very complaint and petition in the present proceeding under § 49, that (p. 2):

"This complaint and petition for a 10-cent fare, with transfer privileges, is filed wholly without prejudice to any of the pending actions and proceedings, relating in part to the rates of fare chargeable on the petitioner's elevated and or subway lines; likewise without prejudice to the petitioner's contentions or claims of right therein, or to its amended tariff schedules filed on February 1, 1928, and its claims of right based thereon."

It is, however, urged by the company that there has been no election because the answers in the state court litigation do not in so many words plead these matters as counterclaims and because they were in any event filed simultaneously with the complaint and petition. They were filed *on the same day* but *prior in time* to the filing of the complaint and petition; and it was the *first in time* that was the one elected. Furthermore the election took place long before the interposition of the state court answers when, on February 1, 1928, the company, seeking to avail itself of the remedy under § 29, filed its revised schedules fixing a 7-cent rate of fare on and after March 3, 1928, on the Manhattan Division. The litigation in the state court and the answers made therein by the company are important, not as showing an attempt by the company for the first time to avail itself of the remedy under § 29, but as evidencing an adherence to and a reaffirmance of its attempt to do so through the filing of its schedules.

The important question with reference to the answers is, not whether they in so many words set up a counter-claim and, hence, whether they constitute the precise equivalent of a suit or proceeding brought by the company, but whether they seek to establish or affirm rights that the company claims it obtained through the filing of the revised schedules and ask for affirmative relief, based thereon.

This is precisely what they do, and the company is thereby showing its adherence to and its reaffirmance of its attempt to avail itself of the remedy under § 29. It is affirmatively relying on supposed rights which it could have obtained by means of that remedy alone, and, hence, by means of its election of that remedy as the basis for its right to an increased fare. Can it, while doing so, require us to recognize rights to which it can be entitled only on the assumption that no rights were obtained through the filing of the revised schedules, and that the 5-cent fare as fixed in the Certificate has obtained to this day?

We cannot agree to the contention that the remedies under §§ 29 and 49 are concurrent and may be availed of simultaneously. Public Service Commission v. Pavilion Nat. Gas Co. (1921) 232 N. Y. 146, P.U.R.1922C, 74, 133 N. E. 427, cited in support of this contention is plainly distinguishable. In that case no question as to the election of remedies was raised or decided by the court. The gas company applied to the Commission under § 72 of the Public Service Commissions Law for an increase in rate. During the pendency of that proceeding the gas company filed new schedules under § 66 *temporarily* increasing its rate *pending* the determination of the proceeding under § 72. The Commission thereupon instituted a summary proceeding under § 74 to enjoin the company from charging the increased rate without its permission.

The court there held that the provisions of the Public Service Commissions Law with reference to gas companies, unlike the provisions with reference to railroads, did not empower the Commission to suspend schedules calling for an increased rate and hence furnished no basis on which the Commission could enjoin the enforcement of those rates as not properly in force. The court also held that § 66 was broad enough to permit the Company to file and put into effect a *temporary* increased rate pending the determination by the Commission of the reasonableness of the old rate.

The situation in that case obviously is not comparable to the one in the present proceeding. The temporary increase was not inconsistent with the rate proceeding. It was purely tentative and wholly subject to the outcome of that proceeding. By filing the schedules calling for the temporary rate the gas company was availing itself of a remedy which was supplementary to and not inconsistent with the remedy invoked through the rate proceeding. There was only one proceeding and the gas company was not seeking, in two separate proceedings simultaneously carried on, to establish the same basic right.

It would seem that the present case involves inconsistent attempts, by following two separate remedies, to establish the same basic rights. The company has not sought to file schedules under § 29 calling for a temporary 7-cent fare pending the determination of the present proceeding under § 49. It proceeded first under § 29 and filed schedules for the purpose, not of fixing any purely tentative fare, but of fixing a permanent 7-cent rate on its Manhattan Division. It now seeks to initiate a rate proceeding under § 49 wholly irrespective of

and without prejudice to its rights under the schedules supposedly filed pursuant to § 29. Obviously, the remedy under § 29 was adopted in the present case, not in connection with or supplementary to a rate proceeding under § 49, but entirely irrespective of and inconsistent with such a proceeding. Here, therefore, unlike the situation in the Pavilion Natural Gas Company Case, the company appears to be seeking to avail itself of inconsistent remedies and is barred by the doctrine of election.

We do not, however, consider a decision of the question of election as necessary to the conclusions we have reached and we here emphasize that our holding on that question is merely that the company cannot maintain this proceeding so long as it insists upon pressing inconsistent claims in the state court litigation. We do not decide whether the company, after the termination of the state court litigation in its favor, if it be so determined, will be at liberty to proceed anew under § 49; and we reserve to it the right to revive or renew this proceeding in that event.

[7] It has been suggested by the company in its brief in this connection that by sustaining the first two grounds of the motion to dismiss, we are sanctioning arbitrary power on our part to "abridge" our jurisdiction under the Public Service Commission Law by merely instituting a suit in the state court and obtaining a temporary restraining order against the maintenance of a proceeding before us.

Such a suggestion presents an inaccurate view of the situation. Quite apart from its disregard of the effect of the suit independently commenced directly by the city and now pending and at issue, it improperly assumes the very conclusion which it purports to indicate. The pendency of the state court litigation cannot serve to abridge jurisdiction that we do not have. It was instituted, not to abridge jurisdiction but to establish whether there is jurisdiction. When we rejected the revised schedules purporting to be filed on February 1, 1928, under § 29, we might have waited for the company to review our decision by *certiorari*. Had we done so, there might have been force in a contention that the *certiorari* pending in the state court might test merely the company's rights under § 29 and leave entirely open its rights under § 49.

Instead of waiting, we sought, by means of the state court litigation, to obtain a direct, immediate, and authoritative determination on the basic question that controls the right of the company to seek escape from the 5-cent rate of fare under any provision of the Public Service Commission Law. By instituting the state court litigation we not merely indicated the view that the company was bound by a nonregulatable, contractual rate of fare, but also afforded the company the best and quickest opportunity to test the propriety of that view in the proper tribunal. By dismissing the present proceeding, we are merely insisting that the company take advantage of that opportunity and obtain an adjudication that we have jurisdiction before it again calls upon us to exercise it.

The consistent course of action adopted by the company throughout the fare controversy is inconsistent

with its assertion of a desire to obtain a speedy determination. It failed to review the propriety of our orders in 1920, 1922, and 1928. It sought to frustrate, by injunction obtained in the Federal court, our effort, through the pending state court litigation, to obtain a speedy and authoritative decision of the fundamental question on which the whole controversy depends. It has opposed the effort for a severance of the issues in the state court litigation which will simplify and facilitate the determination of that question. By announcing in the reply brief submitted to us that (p. 29):

"The procedure in the state court suits is now in a fair way to becoming so involved that they cannot be relied upon as furnishing anything but a battle ground for the determination of procedural questions under the Civil Practice Act," it indicates an intention to continue its dilatory tactics instead of meeting the issues of law that it has tendered.

This attitude has apparently been due to the desire of the company to litigate its claims in the Federal courts, if possible, and in any event, to avoid a consideration in the state courts of the jurisdictional question divorced from complicated and entirely unrelated issues which cannot really arise unless the jurisdictional question is decided in its favor.

We find no justification for the company's announced intention to turn the state court litigation into a "battle ground for the determination of procedural questions under the Civil Practice Act." We are not disposed to encourage it by entertaining the present proceeding; and our duty impels us to dismiss it without prejudice to its revival if the restraining orders are abrogated and final decision rendered in the state court litigation against the claim asserted therein that the 5-cent fare provision is not subject to regulation and change under the Public Service Commission Law.

The grounds considered thus far are sufficient to require a dismissal of the petition at this time, and we base the dismissal, without prejudice, solely upon such grounds.

The company has, however, earnestly requested us not to rely upon these objections as ground for refusing an expression of our views on the primary jurisdictional question. While we deem it unnecessary and improper now to decide that question, and do not hereby intend to do so, but only because it is in issue in the state court and for the reasons above assigned, we shall accede to the request at least to the extent of briefly expressing our present opinion thereon.

[8] We emphatically hold the view that the fare fixed in the Certificate is not subject to regulation or change under any provision of the Public Service Commission Law, and hence that we should have no jurisdiction in the present proceeding even though it was not improperly brought during the pendency of the state court litigation and in violation of the restraining orders.

The Certificate constitutes a contract between the city and the company entered into pursuant to the Rapid Transit Act and upon adequate consideration moving to the company. That act has provided a comprehensive legislative structure for rapid

transit railways in the city. It authorized our predecessor, the Public Service Commission for the First District (hereinafter referred to as the Commission), to enter into the contract expressed in the Certificate and to provide therein for a fixed rate of fare throughout the life of the contract. Its provisions never were and are not now subject to those of the Public Service Commission Law; and the contractual provisions of the Certificate, including that fixing a 5-cent rate of fare, likewise never were and are not now subject to the provisions of that law.

These conclusions are compelled by the history of the Rapid Transit Act, the Public Service Commission Law, the litigation in Admiral Realty Co. v. New York (1912) 206 N. Y. 110, 99 N. E. 241, and the negotiations and events leading up to and surrounding the entry into the contract embodied in the Certificate.

Without at this time undertaking a complete survey of the legislative history of the Rapid Transit Act, we here call attention to a few salient facts surrounding the adoption of the 1912 amendment thereto (L. 1912, ch. 226), which to our minds sufficiently indicate the power and the intention of the parties to the Certificate to contract therein for a non-regulatable rate of fare. These facts embrace also the negotiations between the Commission, the city, and the company which culminated in the execution of Contract No. 3 with reference to the Subway Division as well as the Certificate with reference to the Manhattan Division, all of which were part of the same transaction, negotiated and closed at the same time.

The record of these negotiations is replete with convincing proof that all the parties assumed and recognized that the single unchangeable 5-cent rate of fare on each system (subway and elevated) throughout the respective terms was to be the very cornerstone of the agreements. It furnished the basis for the company's insistence upon the preferential payment provisions specially provided for in the contracts and was one of the most important inducements to the Commission and the city to consent to those provisions notwithstanding the many millions of dollars contributed by the city. The parties did more than tacitly assume that the 5-cent fare provision would have to obtain throughout each term. The Company urged it on the Commission in justification of its demands; the Commission urged it on the board of estimate and apportionment in justification of its acceptance of those demands and a special committee of the board did likewise.

When the contracts were informally agreed upon there was clear unanimity that the 5-cent fare provision in each would constitute a contract, binding on all the parties irrespective of the profits it might yield or the losses it might cause the company. The city had purchased that provision by submitting, at vast sacrifice, to the company's demand for preferential treatment. The company had submitted to the provision because of the tremendous advantage thus received by it and because it prevented the future reduction of the fare below 5 cents regardless of the profits it might earn. For years those profits were such that the 5-cent fare could

not have been maintained but for the recognized binding force of the contracts in that respect.

The preliminary negotiations had hardly closed when the Admiral Realty Company brought a taxpayer's suit to enjoin the execution of the proposed contracts, contending that the city and the Commission, under the Rapid Transit Act, did not have the statutory power to enter into the proposed Contract No. 3 and the Certificate. To meet this challenge, the 1912 amendments to the Rapid Transit Act were introduced into the state legislature. These amendments were specially designed to dispose of all possible question as to the power of the city and the commission to enter into the very contracts which afterwards were executed as Contract No. 3 and the Certificate. They specifically authorized the inclusion in the contracts, both with respect to subway and elevated lines, of all the special provisions on which the parties had informally agreed, such as the compensation to be paid for subway and elevated lines, the leveling of the leases, the privileges of recapture, the preferential payments, etc. And they re-enacted the earlier provisions under which the fare stipulations, both in the subway contract and the Elevated Certificate, were eventually made.

While these amendments were pending, and for the purpose of expediting action thereon, the board of estimate and apportionment on March 21, 1912, passed, and transmitted to the legislature, a resolution requesting prompt legislative authority formally to enter into the contracts incorporating these terms and specially referring to the fact that these contracts would provide for "a single 5-cent fare."

These amendments were thus enacted for the express purpose of authorizing precisely such a contract and certificate as were eventually executed and as had been agreed upon before, because

1. The fact that each of these would contain a provision for a single 5-cent fare was not only a matter of public knowledge, but had been expressly communicated to the legislature by the resolution of March 21, 1912, adopted by the board of estimate and apportionment urging the prompt enactment of these amendments.

2. These particular contracts were at that time the subject of important litigation instituted by the Admiral Realty Company and then pending in the court, in which the question of the single 5-cent fare was directly involved. The very purpose of the amendments of 1912 was to remove all possible doubt concerning the validity of the very contracts, the full terms of which had been informally agreed upon and whose execution the plaintiff in that suit was attempting to enjoin.

The facts thus brought to the attention of the legislature with respect to the intention of the parties to execute a contract and certificate, each containing provisions for a fixed 5-cent fare, were such as to call for some legislative expression of disapproval if the legislature intended not to sanction those agreements.

Instead of expressing disapproval of the contracts thus intended to be made, the legislature in 1912 re-enact-

ed both the provisions of § 27 relating to the subways and the provisions of § 24 relating to Extension Certificates, which, as thus re-enacted, contain the broadest possible authority to the Commission and the city to contract concerning the rate of fare.

The history, therefore, of these amendments and of the litigation connected therewith can leave no rational mind in doubt as to the intention of the legislature to vest the power in the Commission, the city, and the company, both as to subway and elevated lines, to make binding contracts for an unchangeable 5-cent fare.

After the 1912 amendments, the challenge of the power to contract was withdrawn by the plaintiff in the Admiral Realty Co. Case and the brief of each party conceded that the passage of the amendment had conferred the power to enter into all the provisions of Contract No. 3 and the Certificate. The controversy was thereafter confined to the constitutional question of *the power of the legislature* to authorize such a contract.

The same view was uniformly taken by all the New York courts which passed on the case. Scattered through the opinions of all courts in that case are numerous references to the agreement on the single 5-cent fare. Their combined effect overwhelmingly shows that all the New York courts, as well as all the parties there assumed and recognized, as a matter of course, the power of all the parties to enter into a binding contract for a fixed 5-cent rate of fare. Accordingly, the court of appeals on June 29, 1912, delivered an exhaustive opinion holding that Contract No. 3 and the Certificate might properly be executed by the Commission and the city of New York and that they violated no statutory or constitutional rule of law.

Fully to appreciate the effect of the court's decision, it is essential to remember that the plaintiff in the case, as a taxpayer of New York, was contending that the permanent fare limitation of 5 cents, coupled with the preferential payments to the Interborough rendered so highly improbable an adequate return to the city on its investment in the lines that the contracts constituted, in effect, a "gift" of the city's property in violation of the State Constitution.

If the rate of fare was required to be or could be increased under the Public Service Commission Law, should it fail to produce an adequate return for the service rendered or if that law was applicable to the contracts or could be read into them, as is now contended, the question of whether the city was making a "gift" of its property would not have been presented. It was precisely because the court of appeals recognized that the rate limitation was binding during the term of the lease that it became necessary to consider whether the lease, at a permanent 5-cent fare, constituted a "gift" of the city's property.

The court held that the inadequacy of the return to the city at a permanent 5-cent rate was a question for the determination of the city not judicially reviewable. In doing so, the court necessarily assumed that the return would be or might become inadequate; and in conceding this, the court necessarily recognized that the 5-cent rate of fare provided for in

the contracts would not be subject to increase under the Public Service Commissions Law.

Acting under the authority of the Rapid Transit Act as amended for that purpose in 1912, and the decision of the court of appeals sustaining the validity of the contracts proposed to be made, the Commission, the city, and the company executed Contract No. 3, and the Certificate on the same day (March 19, 1913) as a part of the same transaction.

In executing the Certificate, precisely as in the execution of Contract No. 3, the Commission was exercising its contractual authority under the Rapid Transit Act.

Among the "terms, conditions, and requirements" of the Certificate, and the one that was regarded by the parties as the most important, is the provision that the entire system shall be operated "for a single fare" of "5 cents but not more."

The "terms, conditions, and requirements" of the Certificate were accepted by the company on March 19, 1913.

Under the express provisions of §§ 24 and 27 of the Rapid Transit Act, the Certificate could not be executed by the Commission except "with the approval of the board of estimate and apportionment" of the city of New York. Accordingly, on March 19, 1913, the Certificate was approved by resolution, which also set forth in full a copy of the Certificate and in which it was resolved that the Board "hereby consents to the construction, maintenance, and operation of the railroad extensions in accordance therewith."

The foregoing summary of the events leading up to the execution of the Certificate, to our mind indicates conclusively the binding, nonregulatable character of the fare provision in that Certificate.

There is an obvious distinction between rate contracts executed by shippers with carriers or by carriers with municipalities with state authority and such contracts, executed without state sanction. With reference to the latter, which may be referred to as "private contracts," the United States Supreme Court said, in Hudson County Water Co. v. McCarter (1908) 209 U. S. 349, 357, 52 L. ed. 828, 28 Sup. Ct. Rep. 529:

"One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the state by making a contract about them. The contract will carry with it the infirmity of the subject matter."

When considering this class of contracts there is no reason to suppose that the legislature excluded them from the operation of general laws relating to the subject of rate making, over which the legislature, in the absence of contract, has, of course, exclusive control. With respect to the former class, however, there are convincing reasons for assuming that the legislature would not intend to interfere with rates specified in contracts which it had authorized and these reasons become conclusive where the enabling statute is of a special nature and is later, in point of time, than the general law.

The difference between the conditions surrounding the execution of private contracts and contracts authorized by legislation indicates a further reason for the distinction.

Private parties, whether corporate, municipal, or otherwise, frequently enter into contracts with respect to railroad, gas, or other utility rates without attempting to procure the sanction, and without the knowledge, of the legislature. Such contracts, of course, are subject to the police power of the legislature over rates and they may also, whether made before or after the enactment of a regulatory law, be subjected to the jurisdiction of a Commission acting for the state.

But where the parties, contemplating such a contract, appeal to the legislature, for special authorization to contract, and the legislature, in the exercise of its powers, confers that authority by statute, it is inconceivable, and it would be anomalous, if the authority to make a binding contract thus conferred should be held to be subject to the regulatory law. The rule is well settled to the contrary. (Los Angeles v. Los Angeles City Water Co. (1900) 177 U. S. 558, 44 L. ed. 886, 20 Sup. Ct. Rep. 736; Cleveland v. Cleveland Electric R. Co. (1906) 201 U. S. 529, 50 L. ed. 854, 26 Sup. Ct. Rep. 513; Columbus R. Power & Light Co. v. Columbus (1919) 249 U. S. 399, 63 L. ed. 669, P.U.R.1919D, 239, 39 Sup. Ct. Rep. 349, 6 A.L.R. 1648; St. Cloud Pub. Service Co. v. St. Cloud (1924) 265 U. S. 352, 68 L. ed. 1050, 44 Sup. Ct. Rep. 492.)

[9] It is next contended that the Commission and the city had no power to contract for a nonregulatable rate of fare on the Manhattan Division because the authorization "to fix and determine . . . such other terms, conditions, and requirements" in the Certificate "as to the said boards may appear just and proper" was too general to confer authority to contract for a fixed rate of fare. We understand the contrary to be the well-settled rule. It does not require authority to contract as to rates to be conferred specifically by the legislature on a municipality before the latter can contract for a rate of fare that will be free from state regulation during an agreed period.

The Supreme Court of the United States has several times held that authority to contract as to the general subject-matter carries with it inferentially the power to fix a nonregulatable rate during the period of the contract. (St. Cloud Pub. Service Co. v. St. Cloud, *supra;* Vicksburg v. Vicksburg Waterworks Co. (1907) 206 U. S. 496, 51 L. ed. 1155, 27 Sup. Ct. Rep. 762; Cleveland v. Cleveland Electric R. Co. *supra;* Cleveland v. Cleveland City R. Co. (1904) 194 U. S. 517, 48 L. ed. 1102, 24 Sup. Ct. Rep. 756.)

There is nothing in the decision in People ex rel. New York v. Nixon (1920) 229 N. Y. 356, P.U.R.1920F, 1008, 128 N. E. 245, which militates against any of the above stated conclusions.

The Nixon Case arose out of a situation produced by Article III, § 18, of the Constitution of the state of New York, and should not be confused with contracts made pursuant to the Rapid Transit Act. This constitutional provision prevents the legislature from authorizing the construction of a street railroad except with the consent of the local authorities. It does not, however, provide that the legislature may not by statute prescribe and regulate the con-

ditions under which the right to grant such a consent may be exercised by the "local authority." Although the legislature was prohibited from authorizing the construction of a street railroad without local consent, it retained authority to prevent the construction of street railroads, except on such conditions as it might prescribe. (Re Thirty-fourth Street R. Co. (1886) 102 N. Y. 343, 7 N. E. 172; Beekman v. Third Avenue R. Co. (1897) 153 N. Y. 144, 47 N. E. 277).

In this situation the legislature in 1907 enacted the Public Service Commissions Law regulating rates of fare and the question arose (Quinby v. Public Service Commission (1918) 223 N. Y. 244, P.U.R.1918D, 30, 119 N. E. 433, 3 A.L.R. 685) whether the rates of fare upon which local franchises had been conditioned were subject to alteration by the Commission. It was held that at least those franchises between street railway companies and local authorities executed before the enactment of the Public Service Commissions Law (July 1, 1907) were not subject to the jurisdiction of the Commission.

In the Nixon Case, *supra,* the effect of the Public Service Commission Law upon a franchise granted by the city of New York to a street railroad company after the enactment of the Public Service Commissions Law (July 1, 1907) was considered; and it was held that municipalities acting without authority from the legislature had no power by such franchise conditions or contracts "to nullify existing statutes."

It is important to note in this connection that the rate of fare was imposed under the "consent" provisions of the state Constitution and, of course, not pursuant to the Rapid Transit Act, which is not applicable to street surface lines. And since the fare stipulation imposed by the local authorities had not been authorized by the state Constitution, there could be no question that it was subordinate to the power of the legislature to regulate rates. The fare stipulation having been imposed without authority from the legislature and in defiance of the then existing Public Service Commission Law, it was held to be ineffectual because

"The statute which clothed the Commission with jurisdiction to increase charges if found to be inadequate, was notice to municipalities that franchises thereafter granted must be coupled with no conditions inconsistent with the jurisdiction thus conferred. The Commission is now holding the city to terms which were accepted by implication when the conditions were imposed."

This summary of the conditions presented by the Nixon Case, *supra,* is sufficient without further comment to disclose the wide distinction in principle and in its facts between such cases and the present proceeding. The contract in this case, instead of having been made in defiance of the power of the state, was made under express authority and at the command of the legislature. Instead of being in conflict with the prerogative of the state, it was made as the result of a special enactment, sought and secured from the legislature and made expressly applicable to it.

It is precisely as if the state itself had made these contracts with the company and had itself contracted, as

it authorized the city to contract, that the fare should be "5 cents but not more." In the Nixon Case, *supra,* the municipality and the company had agreed concerning the rate of fare in plain disregard of a statute regulating rates. The state had not acted nor directly authorized the contract. The state, in which was vested the supreme regulatory power, was a stranger to the bargain and had withheld and still retained its power over the contract. It was, therefore, entirely logical to hold, as the court held, that the state might intervene in the transaction and demolish the agreement.

The slightest examination of the Nixon opinion will demonstrate that the court was dealing only with the question of the effect of the Public Service Commissions Law in situations where the parties never had any legislative authority to contract for a fixed rate. The court held, and held only, that the law was a sufficiently definite expression of general legislative policy to govern such public utility contracts made after its enactment as would have been subject to regulation if made before its enactment.

Although it was earnestly contended that the language of the law was broad enough to apply to all contracts, the court held it too vague to apply even to rates in prior municipal public utility contracts which the city had never had specific legislative authority to make. The reason given was that contracts already entered into, though without legislative authority and hence subject to subsequent state regulation, had nevertheless produced rights and obligations which were binding as between the city and the public service corporation, and which should remain binding until abrogated by legislation unmistakably applicable thereto. The provisions of the law could apply to such contracts only as a result of "doubtful inference" which the court was unwilling to draw.

In explaining and reaffirming its decision in the Quinby Case, *supra,* the court removed even the pretext for an argument that its construction of the Public Service Commissions Law warrants the conclusion that the law was intended to affect such legislation as the Rapid Transit Act as authorized the city of New York to contract for a fixed rate of fare on its rapid transit lines. If the rate regulating provisions of the Public Service Commissions Law are only "words of doubtful import" which should not be applied "as the result of doubtful inference" even to private contracts concededly subject to regulation, *a fortiori* ought these same provisions be construed, so as to nullify important provisions in a comprehensive later statute dealing in detail with a special subject, not referred to in the rate regulating provisions of the Public Service Commission Law, and to which those provisions can apply only as the result of an inference vastly more doubtful than that rejected in the Quinby and Nixon Cases, *supra?*

These considerations led the United States Supreme Court explicitly to distinguish the Nixon Case, *supra,* and to hold that the Certificate, as well as Contract No. 3, imposed non-regulatable rates of fare. As the court said in Gilchrist v. Interborough Rapid Transit Co. (1929) 279 U. S.

159, 209, 73 L. ed. —, P.U.R.1929B, 434, 452, 49 Sup. Ct. Rep. 282:

"Both the bill of complaint and the argument of counsel here proceed upon the theory that under the law of New York, as clearly interpreted by definite rulings of her courts, the contracts for operating the transit lines impose no inflexible rate of fare. With this postulate we cannot agree. People ex rel. New York v. Nixon, 229 N. Y. 356, P.U.R.1920F, 1008, 1013, 128 N. E. 245, decided July 7, 1920, is especially relied upon; but the circumstances there were radically different from those now presented. The effect of a contract with the city, expressly authorized by amendment to the Rapid Transit Act adopted subsequent to enactment of the Public Service Commission Law, was not involved."

The same considerations lead us to the same conclusion. While we have not stated all the reasons for our lack of jurisdiction to entertain the present proceeding and our lack of power to grant the relief demanded in the complaint and petition, we have stated sufficient to have justified a refusal on our part to assume jurisdiction if the question were now properly before us, which it is not, for the reasons above stated, unless the state court, in the litigation now pending, determines that we may properly exercise it.

We, therefore, dismiss the complaint and petition on the ground that it was improperly brought during the pendency of the state court litigation and in violation of the restraining orders therein; but, as before stated, we reserve to the company the right to revive this proceeding if the restraining orders now in force are finally dissolved and if our jurisdiction is established by means of that litigation.

Inasmuch as the trial of that issue has now been definitely fixed by the Court for October 7, 1929, and will then be pressed by the Commission and can be disposed of unless delayed by the petitioner, the early determination of that issue rests with it.

ORDER

The Interborough Rapid Transit Company having filed with the Commission a complaint and petition, dated June 19, 1929, for an increased fare upon its Manhattan Division; and the Commission having on June 18, 1929, ordered a hearing upon the issue of law and fact presented by said complaint and petition; and a hearing having been held on August 1, 1929, Samuel Untermyer, appearing for the Commission as its special counsel, Arthur J. W. Hilly, corporation counsel, appearing for the city of New York, and William L. Ransom, appearing for the company; and the Commission having limited the preliminary oral argument at the initial session to the question of its jurisdiction to entertain, hear, and determine the petition and to the question whether, because of the pendency of certain litigation in the supreme court of New York and of restraining orders issued therein, the Commission has the right or power to exercise jurisdiction or ought to do so; and it appearing that there is pending in the state courts an action and a special proceeding, in which the question of the jurisdiction of the

Commission is involved, and that restraining orders have been issued in said action and said special proceeding enjoining the company from violating or ignoring the provisions fixing a 5-cent fare contained in its certificate; and the Commission having this day adopted an opinion dismissing the said complaint and petition on the ground stated in said opinion, it is

Ordered that the said complaint and petition of the Interborough Rapid Transit Company, dated and filed June 19, 1929, be dismissed on the grounds stated in the said opinion of the Commission, reserving, however, to said company, the right to revive this proceeding if the restraining orders now in force are finally dissolved, or if the jurisdiction of the Commission is otherwise established or the said litigation is terminated.

NEW YORK DEPARTMENT OF PUBLIC SERVICE, STATE DIVISION, PUBLIC SERVICE COMMISSION

Re Moose River Power Company, Incorporated

[Case No. 5820.]

Security issues — Authority of Commission — Illegal stock issue.

1. The issue of stock by a power company without the authority of the Commission is illegal, p. 285.

Public utilities — Dissolution — Power company which has not functioned.

2. A corporation empowered to engage in the generation and transmission, distribution and sale of electricity and which had bought various lands and water rights, but had never functioned as a public service corporation or obtained any local franchises, must apply to the Commission for authority to dissolve notwithstanding such inactivity, p. 285.

Security issues — Holders of stock illegally issued.

3. The holders of stock of a power company which was illegally issued to them, by reason of the failure to obtain permission of the Commission, although held not to be formal stockholders, were considered, in proceedings to dissolve such company, as individuals having an interest in the petitioning corporation and possibly as constituting potential stockholders, p. 285.

[October 24, 1929.]

PETITION *of a power company for authority to transfer its entire works and system; granted.*

APPEARANCES: Mr. Lyman L. Merriam, President, Moose River Power Company, Incorporated, petitioner; Messrs. Sullivan & Crom-

well (by Baldwin Maull, of counsel), appearing for the Moose River Power Company, Incorporated, petitioner.

VAN NAMEE, Commissioner:

[1] The certificate of incorporation of Moose River Power Company, Incorporated, was filed in the office of the secretary of state on May 5, 1921. Its term of corporate existence is fifty years. By its incorporation papers, its purpose was to acquire from time to time by purchase and otherwise, lands and water rights on the Moose river in Lewis and Oneida counties in the state of New York—such land and water rights to be used for or in connection with or to facilitate the generation, transmission, distribution, sale or furnishing of electricity for light, heat, or power. No stock has ever been issued by the corporation except that said corporation undertook to issue seven shares of stock for the purpose of incorporation but no determination had been made as to the number of shares that were to be issued to each of the seven so-called stockholders who were the actual parties in interest. This was to be determined when a report was made as to the relative value of the ownership of each individual in the assets of the corporation. I have referred to these individuals as "so-called stockholders," for the reason that the issuance of said stock never had been authorized by the Public Service Commission, and the issuance thereof was, therefore, illegal.

[2] While the corporation has bought various lands and water rights as above described, it has never functioned as a public service corporation or obtained any local franchise for the distribution, sale, or furnishing of electricity. Those interested in the company have finally decided to dissolve the corporation and to dispose of its assets and, after the payment of debts, to divide the proceeds among those interested. Having some doubt as to whether the matter came within the jurisdiction of the Commission under § 70 of the Public Service Commission Law, a query was made to the Commission as to whether the Commission considered such application should be made to it. The Commission having replied in the affirmative, holding that under § 5-b of the Public Service Commission Law this corporation was subject to the jurisdiction of the Commission even though it never actually transacted any business or exercised any franchises, the present application for consent to dispose of the assets of the corporation was made and a hearing was held in the city of New York before Commissioner George R. Van Namee on October 14, 1929, those above named appearing.

[3] A copy of the franchise was filed at the hearing and the president of the company gave testimony as to the condition of the company and the reasons for the request for permission to dispose of the property of the corporation. By his testimony, it was shown that all of the seven individuals who owned various percentages of interest in the assets of this corporation had under a trustee agreement transferred their holdings to Mr. Lyman L. Merriam, president of the company, so that upon a dissolution of the entire works and system, the proceeds should go to such trustee instead of having to be split up in

parcels. The trustee was then authorized to sell the property in exchange for stock and to distribute the proceeds in accordance with the ratio of the interests of the various individuals after having paid all the liabilities of the corporation and all expenses in connection with these proceedings.

A copy of an agreement made on the 8th day of October, 1929, between the so-called stockholders was introduced in evidence. In this agreement, the percentage of each of the so-called stockholders in the assets of the corporation, after its debts and liabilities are paid was set forth. The trustee, Mr. Merriam, is to transfer all of the assets of the corporation to Charles E. Norris as nominee for F. L. Carlisle & Company, Incorporated, in exchange for 30,000 shares of the common stock of Niagara Hudson Power Corporation.

The agreement states: "Immediately thereafter he shall sell at approximately current market prices a sufficient part of said stock to satisfy all debts and liabilities of the corporation then unsatisfied, whether assumed by the stockholders or not, and all his expenses as trustee, and shall apply the proceeds of sale thereof to the satisfaction of such debts, liabilities and expenses."

After making provision for taking care of certain other obligations due to the so-called stockholders, by the delivery to them of certain shares of said stock, in kind, the agreement provides that said trustee shall distribute the remaining shares of stock of the Niagara Hudson Power Corporation received by him as aforesaid among the parties thereto as follows:

Per Cent	To
20.5005	Lyman L. Merriam
21.3944	Florence Lyon Merriam
15.9917	C. Leonard J. Agar
3.0786	C. W. Tillinghast Barker
16.9689	Augusta Merriam Hone
2.0572	Lyon deCamp
20.0087	Sir Ion Hamilton Benn

There seems to be no reason why this corporation should not be given permission to transfer its property in exchange for stock of the Niagara Hudson Power Corporation, as it proposes. Nor do I see any reason why the stock so received should not be disposed of (so far as necessary) for the payment of debts of said corporation, and the remainder distributed in the manner proposed. As this Commission has never authorized the issuance of any stock by the petitioner herein, it, of course, can not formally recognize the several so called stockholders as legal stockholders, but will have to regard them as individuals having an interest in the petitioning corporation, possibly as constituting potential stockholders, but not actual stockholders. In addition, nothing in the order to be adopted herein should be construed as an authorization or attempted authorization of the issuance of any stock by Niagara Hudson Power Corporation.

An order in accordance with the foregoing is hereto attached.

Commissioners Pooley, Lunn, and Brewster concur; Chairman Prendergast not present.

Re Sinking Spring Water Company

Security issues — Improper financing — Holding companies.

A proposed bond issue equal to 80 per cent of the depreciated reproduction cost of a water utility which, under existing rates and operating expenses, only earned the fixed charges on the issue 1.6 times before, and 1.25 times after, deduction for Federal taxes and depreciation, was disapproved as a means of financing dangerous to the interest of the public where the entire bond issue was made to purchase the company's own securities in connection with the sale of the properties to a holding company outside the state.

[November 12, 1929.]

APPLICATION *of a water utility to file certificates of notification for certain security issues; application denied and certificates held to be unacceptable.*

By the COMMISSION: Under date of September 24, 1929, two certificates of notification were presented for filing with the Public Service Commission by the Sinking Spring Water Company; one in the matter of the proposed issuance of $300,000 par value of first mortgage 5 per cent gold bonds and another relating to the proposed issuance of 1,000 shares of no par capital stock in place of a like number of shares of the par value of $50. Upon request of the Commission additional information was submitted under date of October 19, 1929.

From the voluminous detail involved in these issues the Commission is able to deduce the following pertinent and controlling facts:

Prior to the issuance of the securities provided for in these certificates the capital structure of the Sinking Spring Water Company consisted of 1,000 shares of $50 par stock, and $70,000 in bonds. In addition to this, the Wyomissing Spring Water Company, the plant of which is leased and operated by the Sinking Spring Company, has outstanding capital stock in the amount of $13,500. As compared with these securities totaling $133,500, the certificates contemplate the issuance of a bond issue of $300,000, and 1,000 shares of no par stock.

These bonds are secured ultimately by a mortgage of the properties of the two companies which are carried on the books at $258,389. This property has been appraised by engineers representing the company at a reproduction new cost of $429,958 and depreciated at $375,108. The proposed bond issue of $300,000 is, therefore, equal to 80 per cent of the depreciated reproduction cost, and under existing rates and operating expenses the fixed

charge on this issue is earned only 1.6 times before, and 1.25 times after deduction for Federal taxes and depreciation.

It also appears that these changes in corporate structure are made as part of a purchase of the property by a holding company outside the state. By this sale it is proposed to replace the outstanding bonds by $82,000 of new bonds, replace $22,000 of stock now held in trust by $150,000 of new bonds, and the remaining $68,000 in bonds is to be paid in addition to some $200,000 in cash over a period of four years for the remaining $28,000 of stock outstanding and the $13,500 stock of the subsidiary company. The capital stock of the subsidiary is thereupon to be turned over to the Sinking Spring Company and that of the latter company to the Reading Trust Company as depository. The entire bond issue is, therefore, made to purchase the company's own securities, in large part its own capital stock.

This Commission has had transactions of this sort before it on at least two occasions. As has been said, it has no interest in the capital structure as such of public service companies, but it does have a very great interest in such matters when they are managed in such a way that they seriously threaten the continuity of the company's service and the reasonableness of its rates.

"While it is true that rates must be based on fair value and not on corporate fixed charges or the amount of outstanding stock or bonds, nevertheless these items are made factors by the Public Service Company Law in the determination of fair value, and this Commission would never sanction but would exert its full power to prevent the creation of a capital structure for a public service company under its jurisdiction which would so burden the company with fixed charges as to force it to curtail its service or seek increased rates not justified by the fair value of its property." Graff v. Williamsport Water Co. (1929) 9 Pa. P. S. C. —, P.U.R. 1929D, 135, 136.

From a knowledge derived from all its experience in these matters, the Commission is strongly of the opinion that the financing here involved and the proportion of fixed charges to revenue are matters dangerous to the public service of the company, the consummation of which this Commission should do its utmost to prevent.

The company will, therefore, be advised that these certificates are not acceptable for filing as certificates of notification.

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